

**Assessment of the Five-Year Impact of the
U.S.-Vietnam Bilateral Trade Agreement on
Vietnam's Trade, Investment, and Economic
Structure**

PREFACE AND ACKNOWLEDGEMENTS

The Central Institute for Economic Management (CIEM) and the Foreign Investment Agency (FIA) of the Ministry of Planning and Investment (MPI) and the U.S. Agency for International Development (USAID)-funded Support for Trade Acceleration (STAR) project have been requested by the Vietnamese Government Steering Committee for Technical Assistance on BTA Implementation and USAID to provide analysis on the impact of the U.S.-Vietnam Bilateral Trade Agreement (BTA) on trade, foreign investment, and economic structure in Vietnam, with a particular focus on bilateral relationships with the United States. This report builds upon several previous reports by our three institutions: *An Assessment of the Economic Impact of the United States-Vietnam Bilateral Trade Agreement: Annual Economic Report for 2002* (with two semi-annual updates in 2003 and 2004), and *The Impact of the U.S.-Vietnam Bilateral Trade Agreement on Overall and U.S. Foreign Direct Investment in Vietnam*, which was released by the MPI/FIA and USAID/STAR in 2005.

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All remaining errors and omissions, and, of course, the interpretations and opinions expressed in the assessment, are the sole responsibility of the authors.

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EXECUTIVE SUMMARY

This report assesses the impact of implementing the U.S.-Vietnam Bilateral Trade Agreement (BTA) on Vietnam's trade, foreign investment and economic structure over the five years following its coming into force on December 10, 2001. It particularly focuses on bilateral relationships between the two countries in the context of the parallel and mutually reinforcing process of Vietnam's accession to the World Trade Organization (WTO), completed on January 11, 2007. The report is co-authored by research staff from the Vietnamese Ministry of Planning and Investment's Central Institute for Economic Management (CIEM), the Ministry's Foreign Investment Agency (FIA), and the Support for Trade Acceleration (STAR Vietnam) Project funded by the U.S. Agency for International Development (USAID).

THE BTA AS A STEPPING STONE TO THE WTO AND STRONGER BILATERAL RELATIONS

Over the last five years, the Vietnamese and U.S. governments have achieved much of what they set out to do when the U.S.-Vietnam Bilateral Trade Agreement normalized economic relations between the two countries. When the BTA came into force on December 10, 2001, the United States immediately extended Normal Trade Relations/Most Favored Nation status (NTR/MFN) to Vietnam, reducing its average tariff rates on Vietnamese imports from around 40 percent to around 4 percent. Literally overnight this move effectively opened up the largest and most receptive market in the world to Vietnamese exports. In turn, Vietnam agreed to initiate comprehensive reforms to bring its laws, regulations, and administrative practices much more in line with international practice, and to liberalize market access, in particular, for a number of major service sectors.

The subsequent rapid expansion in bilateral trade and investment between the two countries translated the BTA's policy changes into economic reality. For many, especially among Vietnamese, the results have far exceeded expectations. The United States has become Vietnam's largest market for exports and one of Vietnam's largest suppliers of investment, while Vietnam has become one of the

fastest-growing markets for U.S. exports. The BTA's successful implementation had an important political - economic impact as well, raising the confidence of Vietnamese exporters and spurring political will to speed up negotiations on accession to the World Trade Organization (WTO).

Fulfilling the two governments' promise that the BTA was a "stepping stone" toward WTO accession, Vietnam formally became the 150th member of the WTO on January 11, 2007. By design, the BTA was built upon WTO principles. Vietnam used the first five years of BTA implementation quite productively, making fundamental changes in almost one hundred laws and regulations—changes that were needed both to successfully implement the BTA and to accede to the WTO. At the same time, phased-in market openings for U.S. firms under the BTA, especially for services, gradually increased foreign competition in the Vietnamese economy, helping the country prepare for the much more comprehensively liberalized market access required for WTO accession.

Full bilateral economic normalization was completed in December 2006 when President Bush extended permanent normal trade relations (PNTR) to Vietnam, following a PNTR authorization vote by the U.S. Congress. The United States revoked the U.S.-Vietnam Textile Agreement, which had imposed quotas on Vietnamese apparel exports, when Vietnam formally entered the WTO. In June 2007, just months after Vietnam's accession to the WTO, the two countries signed a bilateral Trade and Investment Framework Agreement (TIFA), which can provide an initial step toward developing a full-scale bilateral free trade agreement.

THE PATH TO LIBERALIZATION

An Urgent Need to Modernize the Economy and to Generate Jobs

As the BTA was being finalized in 1999 and 2000, Vietnam was struggling to rebound from the negative effects of the Asian financial crisis, which had slowed export and foreign investment growth. The government also had to address fundamental domestic economic issues. As the result of a postwar baby boom, around half of all Vietnamese are younger than 25. Jobs were therefore needed for the estimated 1.5 million young people entering the labor force each year. Jobs were also needed for millions of rural Vietnamese, in order to continue to reduce poverty in the countryside.

Furthermore, Vietnam's export structure was highly distorted as a result of limited access to the U.S. market because economic relations had not yet been normalized. Given Vietnam's large and literate labor force, it would have been

expected that Vietnam would be exporting predominantly labor-intensive, manufactured goods. Unlike those of its neighbors, however, Vietnam's exports before the BTA were dominated by primary products, and the United States was one of its smallest export markets.

Given these economic and demographic factors, and Vietnamese leadership's political priorities—to maintain social stability, reduce poverty, and stimulate broad-based, rising prosperity, each of which required the rapid generation of new jobs—Vietnam's development strategy increasingly centered on accelerating its transition to a market-oriented economy with a rapidly growing private sector. It also needed to find new markets for its exports, especially labor-intensive manufactured goods, which focused attention on opening access to the U.S. market in particular, and on integrating more deeply into global markets generally. The shift toward a more market-oriented, private-sector-driven, export-led development strategy, which followed in the tradition of its successful neighbors throughout East Asia, was seen as the best way to generate the millions of jobs and rising incomes needed to achieve Vietnam's ambitious socio-economic development objectives.

The BTA Helps to Catalyze Reforms on Many Fronts

Vietnam made the astute decision to use trade agreements as a leading element of a more systematic modernization of its economic policy and laws. In 1995, just as the United States and Vietnam normalized political relations and a year after the U.S. embargo had been lifted, Vietnam initiated negotiations to normalize economic relations with the United States through the BTA. It also opened negotiations to accede to the WTO and joined the Association of Southeast Asian Nations (ASEAN) Free-Trade Agreement (AFTA). The BTA and WTO agreement are "modern" trade agreements, obliging signatories not just to lower import tariffs and eliminate quotas for goods, but also to open market access for services, strengthen intellectual property rights (IPR) protection, develop foreign investment, and enhance legislative and regulatory transparency, commercial dispute settlement, and business facilitation.

While Vietnam adjusted many laws and regulations to comply with the international standards incorporated in the BTA and WTO agreements, it also developed many other laws and regulations not required directly by the trade agreements to support the operations of a domestic market economy with a growing private sector. Examples include a highly effective enterprise (company) law, major improvements in contract law, new laws on financial instruments and capital markets, and revisions to tax and land laws. The court system has been consolidated and made more independent, and court and arbitration procedures

have been modernized—especially important given the need to resolve commercial disputes effectively. Transparency in legislative, legal and regulatory systems has been greatly enhanced, an advance that is essential to more effective economic governance.

Likewise, the government has significantly loosened restrictions on market activity for both domestic and foreign firms over this period. It has become much easier to establish and expand a business, as witnessed by the creation of more than 160,000 private firms and the flourishing of foreign-invested firms in Vietnam. These firms can operate more openly in most sectors, on an increasingly level playing field with state-owned enterprises (SOEs). Corporate governance regulations have been strengthened for all firms, as has access to finance and capital. State-owned enterprises are being increasingly equitized or rationalized. The BTA helped directly to open market access for more than 20 major service sectors and other investment sectors for U.S. (and in many cases other foreign) investors and service providers. It also reinforced Vietnam's movement toward modernizing customs procedures, eliminating most import quotas, and liberalizing and streamlining import/export trading rights.

The BTA's defining impact on Vietnam was not to reduce tariff barriers for the import of goods, as one might expect from a trade agreement. In fact, Vietnam reduced duties on only 261 tariff lines. Rather, the BTA served as a catalyst for systematic reform, its substantive requirements and implementation deadlines helping Vietnam focus on a number of fundamental needs:

- to develop a rules-based system of commercial law and regulatory procedures more in line with international best practice and the needs of a market economy;
- to advance the development of a number of fledgling service sectors; and
- to spur export and investment growth through the opening of the U.S. market.¹

1. As discussed below, given that tariff reductions must be applied to all countries on an MFN basis, both countries shifted negotiations on major tariff reductions from a bilateral context to the multilateral WTO accession negotiations, where free-rider considerations could be more directly accounted for. Extensive bindings and cuts in tariff levels were negotiated as part of the WTO accession process, as described in more details in Chapter 2.

CHALLENGES AHEAD

The Implementation Gap

Much of the legal reform accomplished over the past five years has focused on improving the framework for commercial activity—the “rules of the game.” Other needed elements, however, have evolved more slowly, in particular those involving modernizing and adjusting the organization, functional focus, administrative procedures, and incentives in Vietnam’s State institutions. A key challenge for Vietnam over the next five to ten years will be to implement these many reforms more effectively in practice. Specifically, Vietnam must overcome a widely perceived “implementation gap” between the greatly improved letter of the law and the realities on the ground of continuing administrative red tape, bureaucratic ennui, regulatory burden, and rent seeking.¹

One result of this gap may be the recent decline in Vietnam’s relative position in international competitiveness ratings: its rankings actually dropped several positions in both the World Economic Forum’s Global Competitiveness Index and the World Bank’s Doing Business Report. The rankings show that for all Vietnam’s reform activity, it’s the reality of how law and policy are applied to everyday business operations that truly matters.² These global, comparative indices also reflect that even though Vietnam may very well be making improvements over time, it may not be keeping pace with other countries that are reforming even more rapidly.

Improving the effectiveness of government administration, of course, is an

1. Along with many recent reforms, there is increasing evidence that there has been a creeping resurgence in administrative red tape, permits, inspections by regulators of regulatees, and, more generally, regulatory burden. This has occurred not so much as a systematic policy—many of the new legal reforms aim to improve the business environment—but more as an unintended consequence of developing so many new laws and regulations to deepen the Vietnamese commercial legal system. Given the tradition of legal development in Vietnam, each new law or regulation introduces new administrative procedures for compliance, new inspection procedures, and so on. In each case, the new rules and procedures may be less burdensome and more targeted than in the past, but cumulating so many new laws and regulations actually causes the overall regulatory burden on a private firm to be greater. And, in some cases, new regulations have been added that increase the regulatory burden purposefully (such as the new requirement that larger private investment projects be evaluated and approved by the government).

2. In the World Economic Forum’s Competitiveness Index for 2006, Vietnam dropped from 74th in 2005 to 77th in 2006 out of 125 countries; in the World Bank’s Doing Business Report, Vietnam fell from 98th in 2005 to 104th in 2006 out of 175 countries. These global surveys are based predominantly on interviews and surveys with businesses operating in each country, who emphasize not only legal reforms, but also how reforms are applied in practice.

ongoing —and difficult—challenge for every country. Recently, Vietnam has put considerable effort into creating programs to improve public administration and to reduce corruption, both key factors for reducing the implementation gap. But, much more will need to be done. Over the next five years, Vietnam plans to develop a number of new laws that aim directly to improve institutional capabilities. These will include laws to further enhance transparency, strengthen the courts, focus the responsibilities of the procuracy, develop more effective government administrative and appeals procedures, and reduce excessive regulatory burden on businesses. These efforts are all focused on better implementation and enforcement of laws and policies both nationally and locally.

The Infrastructure Gap

Vietnam also faces a serious “infrastructure gap.” To sustain its rapid growth, take full advantage of the new opportunities opened by the BTA and WTO, and handle greater foreign competition as trade barriers decline, Vietnam needs more and better private and public investment in its physical and social infrastructure. Of particular importance is to improve Vietnam’s capacities in education, vocational training and health systems, and in its transportation, communication and energy sectors.

The Promise of Current Progress

If the past is any indication, Vietnam should continue its progress toward its ambitious goals of becoming a middle-level developing country in 2010 (achieving per capita income of US\$1,000, compared with around US\$620 currently) and approaching developed status by 2020. Vietnam has averaged around 7 percent growth consistently over the last decade; with growth rates exceeding 8 percent in 2005 and 2006 suggesting that an even more robust growth trend may be emerging. It continues to have one of the world’s most successful efforts to reduce poverty, and its socioeconomic development outpaces that of most other countries at similar per capita income levels.¹ However, to achieve these development goals will require strong political will to improve institutional capabilities and large increases in private and public investment for physical and social infrastructure. The foundation for incorporating international best practices with regard to legal and administrative practices and for the rapid increase in foreign trade and investment needed to succeed in this effort has been laid by Vietnam’s successful

1. Even though poverty levels are falling, and the vast majority of Vietnamese are better off now compared to the dire economic conditions of the 1980s, rapid economic growth in Vietnam appears also to be creating income disparities and concentrations of wealth and income that can raise social and political stress.

implementation of the BTA and accession to the WTO.

KEY FINDINGS ON FOREIGN TRADE AND THE BTA¹

Bilateral Trade

Vietnamese exports to the United States boomed following the BTA, leveling off after implementation of the U.S.-Vietnam Textile Agreement. The most direct impact of the large BTA-initiated cuts in U.S. tariff rates was an increase in Vietnamese exports by 128 percent in 2002 and then another 90 percent in 2003. This increase was led by a surge of 1,764 percent in apparel exports in 2002, followed by 164 percent in 2003 (see Figures 1 and 2). By 2003, apparel exports made up around 50 percent of total exports to the United States. With the implementation of the U.S.-Vietnam Textile Agreement, which established quantitative limits of around 7 percent annual growth starting May 2003, Vietnam's overall export growth to the United States moderated considerably. However, export growth still ran between 16 and 29 percent for 2004, 2005 and 2006; even better, this export growth was driven by an increasingly diversified group of manufactured exports. Overall, from 2001 to 2006, Vietnam's exports to the United States increased more than eightfold.

It is unclear how the U.S. elimination of the apparel quotas in January 2007 will affect the situation. If Vietnam reacts like other apparel-exporting countries whose textile quotas ended in January 2005, it can be predicted that Vietnamese exports of apparel will grow between 20 to 30 percent over the next several years, compared to 7 to 8 percent in 2004 and 2005. This could boost the trend of overall Vietnamese exports to the United States over the next several years (see Table 2). On the other hand, the United States has developed a special textile monitoring mechanism for apparel imports from Vietnam that may limit export growth.

The United States has become Vietnam's largest export market. In just two years after BTA implementation, the United States went from one of the

1. This study faces a fundamental methodological challenge—how can the impact of a requirement in the BTA be linked directly to changes in economic activity? In some cases, such as the impact of lowering U.S. tariffs on Vietnamese exports, it is possible to show a direct impact of the BTA on Vietnam's trade and investment flows. In many other cases, however, it is not possible to distinguish a singular impact from the BTA among the many other related reforms that Vietnam has carried out over the last five years. In these cases, we compare trends before and after implementation of the BTA to provide an indication of how the package of BTA and other systematic reforms affected trade and investment flows. We are happy to make all data available to other researchers, and we encourage others to delve more deeply into these many interesting issues.

smallest to Vietnam's largest export market, leveling off at around 20 percent of overall Vietnamese exports (see Figure 1).

Vietnam now predominantly exports manufactured goods to the United States. In 2001, before the BTA, 78 percent of all Vietnamese exports to the United States were primary goods, mainly shrimp and petroleum products (see Table 4). By 2003, after just two years of BTA implementation, manufactured exports were 72 percent of total exports to the United States, leveling off later at about 74 to 75 percent. The initial surge in 2002 and 2003 in manufactured exports was dominated by the huge increase in apparel exports. However, non-clothing manufactured exports have grown solidly each year since BTA implementation. They became the fastest-growing segment of manufactured exports from 2004 to 2006, accounting for almost one-half of all manufactured exports in 2006 (see Figure 2). While apparel, footwear, and furniture products account for around 80 percent of total manufactured exports, exports of data-processing machines, telecom equipment, electrical machinery, travel goods and miscellaneous manufactured products such as toys and plastic articles have grown strongly over the last several years (see Table 3).

Non-oil primary product exports to the United States grew modestly. Although rising manufactured exports dominated overall growth in Vietnam's exports to the United States, primary products nevertheless grew solidly, nearly tripling over the five years since the BTA (see Table 4). Much of this growth, however, was attributable to a nearly six-fold increase in petroleum exports. Fish and seafood exports (primarily shrimp) have had a somewhat rockier history. They had reached nearly US\$500 million even before the BTA took effect, and they rose by another 50 percent over the first two years of BTA implementation. This segment's export growth to the U.S. market reversed, however, after the United States applied antidumping duties on Vietnamese exports of fish fillets and then shrimp (see Figures 4 and 5). Although clearly these antidumping actions imposed a cost, they also revealed an opportunity. Vietnamese seafood exporters rapidly found markets in other countries for fish and shrimp, such that total Vietnamese exports of these products actually have increased substantially over the last five years (see Table 5 and Figure 6).

U.S. exports to Vietnam more than doubled. Although in assessing the impact of the BTA, much of the focus has been on the surge in Vietnam's exports to the United States market, U.S. exports to Vietnam also have grown strongly, more than doubling over the last five years (see Figure 7 and Table 6). The pattern of this growth, however, has been irregular. Total U.S. exports almost tripled in the first two years following the BTA, and then declined over the subsequent years. This was the result of a major purchase of U.S. aircraft

(predominantly big ticket Boeing 777s) by Vietnam just after the BTA came into force. These were reported as U.S. exports when they were actually delivered to Vietnam, mainly in 2003, and then less so in 2004 and 2005. Stripping out transport equipment, U.S. exports have grown at a relatively steady and solid 20 percent a year. U.S. exports to Vietnam consist mainly of transportation, machinery, and other manufactured products, as well as food and other primary products.

Overall Vietnamese Trade

The surge in exports to the United States boosted overall Vietnamese trade in the aftermath of the Asian financial crisis; by 2006, Vietnam exports were distributed evenly among four major markets. As the malaise from the Asian financial crisis had been lifted, the surge of Vietnamese exports to the United States accounted for more than 80 percent of overall growth in Vietnamese exports in 2002 (see Table 7). The United States became Vietnam's biggest export market in 2003, accounting for around 20 percent of total exports. Over the last three years, as the bilateral trade relationship with the United States has matured and as other export markets have been strengthened, export growth to the United States, European Union (EU), ASEAN, and Japan has evened out. In 2006, Vietnam shipped roughly 15 to 20 percent of its overall exports to each of these major markets. This represents a quite healthy diversification of export markets for Vietnam.

The United States remains a minor source of imports for Vietnam. While Vietnam's overall imports have grown rapidly since the BTA, the share of imports from the United States remained at around 2.3 percent between 2000 and 2005 (see Table 7). The United States has thus benefited from Vietnam's robust economy, but it has not been able to increase its market share relative to other competitors. Dominant suppliers of imports to Vietnam, by order of magnitude in 2005, are ASEAN, China, Taiwan, Japan, Korea, and the EU.

While Vietnam has a large bilateral trade surplus with the United States, it runs a substantial trade deficit overall. Vietnam's trade surplus with the United States has grown rapidly over the five years of BTA implementation, from around US\$600 million in 2001 to around US\$7.5 billion in 2006 using data from the U.S. International Trade Commission, and from around US\$650 to US\$6.8 billion using Vietnamese data. Even with this substantial growth, however, Vietnam accounts for less than 1 percent of the overall U.S. trade deficit (see Table 8). There is little evidence that this trade surplus is generated from "mercantilist" policies. Instead, the cause appears to be largely structural. Vietnam tends to export most of its products to four major markets, the United

States, EU, Japan and ASEAN, while most of its imports come from Asian economies. For apparel, for example, which accounts for around 50 percent of all Vietnamese exports to the United States, only around 5–10 percent of the value of the apparel export is generated as domestic value added. The rest of the value comes from imported inputs for the final apparel good, sourced largely from Asian suppliers. Differentiating Vietnam strongly from China, Vietnam has increased its overall imports more rapidly than its exports. Its trade deficit with the rest of the world significantly exceeds its bilateral surplus with the United States. Vietnam's overall trade deficit has increased from US\$1.2 billion to US\$5.1 billion between 2001 and 2006.

KEY FINDINGS ON FOREIGN INVESTMENT AND THE BTA

The importance of foreign direct investment (FDI) in Vietnam's economy is substantial. As reported in Vietnam's WTO Working Paper, foreign investment projects as of December 2005 accounted for 18 percent of total invested capital, 31 percent of Vietnam's export revenue, and 37 percent of industrial output, contributing nearly 14 percent of Vietnam's gross domestic product (GDP). Foreign investment projects had created some 620,000 jobs directly, and several hundred thousand jobs were indirectly dependent on these projects.

Overall FDI into Vietnam

Overall FDI into Vietnam initially grew modestly after the BTA, building to a boom in 2005 and 2006. From 2000 to 2003, FDI plummeted worldwide, particularly in developed countries but also in most developing countries (see Figure 10). In Vietnam, by contrast, FDI grew modestly from 1999 to 2003—registered FDI grew by 24 percent and implemented FDI by 13 percent (see Figure 9). From 2003 to 2006, moreover, FDI into Vietnam boomed, with registered FDI surging by almost 375 percent to around US\$12 billion, while implemented FDI grew by 55 percent. Given the normal lag between registered and implemented FDI, implemented FDI should grow even more strongly over the next several years. Standing out in the recent surge, for example, was Intel's 2006 announcement that it would invest around US\$1 billion in a chip factory in Ho Chi Minh City. Registered in 2006, this investment will be implemented over the next several years as the facility is constructed and equipped. Investor confidence has risen for a number of reasons, including the effective implementation of the BTA, Vietnam's accession to the WTO, an improved local business environment, and good prospects for continued strong economic growth.

FDI grew strongly in sectors where Vietnamese exports to the United States grew the fastest after the BTA. The most direct economic impact of the

BTA was the U.S. extension of Normal Trade Relations (MFN) status for Vietnamese goods. The newly opened U.S. market served as an outlet for repressed comparative advantage by Vietnamese firms, especially in labor-intensive sectors such as apparel, footwear, and wood processing and furniture products. Data show that FDI poured into these three sectors from 2000 to 2005, expanding by more than sevenfold over this period (see Figure 14). This FDI can be attributed directly to the BTA. As would be expected, most of this FDI originated from neighboring Asian economies, with almost none originating from the United States, which has few firms specializing in production of these types of labor-intensive goods. U.S. firms were directly involved with buying and distributing many of these products,

The size of FDI projects increased after the BTA. Having shrunk dramatically over the 1990s, the average size of registered FDI projects began to climb steadily from 2002 to 2005. This new trend could reflect increasing confidence by foreign investors in the legal environment underpinning investment in Vietnam following the BTA, likely reinforced by Vietnam's successful accession to the WTO. It could also reflect the more capital-intensive needs of a rapidly expanding, industrializing economy with a domestic market of over eighty million people growing at a sustained rate of 7–8 percent a year.

U.S. FDI into Vietnam

A new metric for U.S. FDI is updated. A long-standing anomaly is the fact that U.S.-sourced FDI in Vietnam has normally been reported as relatively low: for example, the United States ranked 11th among all countries with FDI in Vietnam in 2004, considered on a cumulative basis since 1988. This clashes sharply with the “walking the street” perception, where one sees many advertisements and signs for seemingly U.S. firms. This report updates a new metric—“U.S.-related FDI”—that was developed for our previous Investment Report (2005). The metric adds FDI from overseas U.S. subsidiaries located in third countries to the normal “bilateral” investment flows sourced directly from the United States. For example, the major Intel investment is reported as FDI from Hong Kong, since the investment was made by an Intel subsidiary operating in Hong Kong. In our metric, it would also be listed as a U.S.-related FDI, since it was made by a U.S.-based firm. Overseas U.S. subsidiaries investing into Vietnam are concentrated in Singapore, Hong Kong, the Netherlands, and various island tax heavens (see Table 13). Reasons why U.S. firms invest into Vietnam through overseas subsidiaries include incentives in the U.S. tax law and advantages in overseeing management of their investments from regional headquarters. Data on U.S.-related FDI are available only up to June 2006.

U.S.-related FDI into Vietnam is much higher than normally reported in

official statistics. For FDI accumulated from 1988 through June 2006, U.S.-related FDI was \$4 billion for registered projects and \$3.3 billion for implemented projects, compared to \$2.0 billion and \$777 million respectively for normal, bilaterally-sourced FDI from the United States (see Table 13). That is, U.S.-related registered FDI was almost twice as high and U.S.-related implemented FDI was more than four times as high as respective totals for normally reported bilateral FDI. Although it is not possible to compare U.S.-related investment to similar investment from other countries (our reports collect “related” FDI only for the United States), these figures would place U.S.-related firms among the leading investors in Vietnam as accumulated over the last 20 years.

U.S.-related FDI into Vietnam surged after the BTA, but was not adequately picked up by the normally reported bilateral FDI flows. U.S.-related registered FDI surged from US\$216 million in 2001 to US\$1.05 billion in just the first six months of 2006, while U.S.-related implemented FDI grew strongly as well, from US\$258 million in 2001 to US\$1 billion in the eighteen months from January 2005 to June 2006 (see Figures 14 and 15). Conversely, normally reported bilateral registered FDI from the United States actually declined from 2002 to 2004, only starting to grow in 2005, while reported implemented FDI from the United States remained lethargic from 2001 through to June 2006, except for a moderately strong number for 2003. Thus the normal bilateral metric, while correctly calculated, is misleading if used alone. It is important to note that the BTA covers such U.S. investment by overseas subsidiaries to the same degree as FDI sourced directly from the United States.

U.S.-related FDI into Vietnam ranked among the highest of FDI from all countries from 2003 to mid-2006. Data released in our earlier report showed that U.S.-related FDI was the largest source of FDI into Vietnam for 2003 and 2004. Although it is not possible to extend this comparison to the period from 2005 to mid-2006, U.S.-related implemented FDI exceeded \$1 billion and U.S.-related registered FDI reached around \$1.4 billion over these 18 months, reflecting a continuing strong increase in U.S.-related FDI into Vietnam. FDI from many other countries increased rapidly over this period as well. It is not important which country’s FDI grew fastest; the key point is that both U.S.-related FDI and FDI from a number of other countries grew strongly over 2005 to mid-2006, reflecting the improving legal and policy environment related to the implementation of the BTA, the successful negotiations to accede to the WTO, Vietnam’s even broader systematic legal system, and confidence that Vietnam’s economy will continue to grow rapidly.

U.S.-related FDI is concentrated in capital/skill-intensive sectors, in a

few provinces, and in 100-percent-foreign-owned enterprises. U.S.-related implemented FDI is spread among a number of largely capital/skill-intensive sectors. Roughly half is in the petroleum sector, around one-third in manufactured sectors, and the rest in services, property development, and agriculture (see Tables 12, 14 and 15). Note that FDI in services are relatively smaller in terms of monetary flows than in terms of their actual development impact, since much of what is actually transferred in FDI by services is human and organizational capital, which are not picked up in FDI data. U.S. firms' extensive FDI in the petroleum sector is not classified by location, and by regulation must be in the form of business cooperation contracts. Excluding oil and gas investment, more than 80 percent of U.S.-related implemented FDI is located in three provinces/cities in the south around Ho Chi Minh City (Ho Chi Minh City, Binh Duong and Dong Nai) and two provinces/cities around Hanoi in the north (Hai Duong and Hanoi). Even before the big Intel investment, Ho Chi Minh City accounted for around 40 percent of all non-oil U.S.-related FDI into Vietnam. Almost 60 percent of all non-oil U.S.-related implemented FDI is done through 100 percent-foreign-owned enterprises, with most of the rest through joint ventures.

Indirect Investment

Indirect investment into Vietnam is surging, with a substantial portion of it from U.S. sources. Over the last several years, foreigners, including especially Americans, have been rapidly increasing indirect investment into Vietnam. They have bought equity in Vietnamese firms on the booming stock market, as well as making substantial purchases through private equity placements. The number and size of foreign investment funds are soaring; they are estimated to have attracted at least US\$1 billion of investment to Vietnam from BTA implementation until mid-2006. More recent data as of June 2007 show these numbers to have increased substantially (The Brief, 2007). Large international institutional investors also appear to be increasingly interested in participating in Vietnam's equity market. Interviews with fund managers indicate that speaking very roughly, one-third to one-half of the money flowing through foreign investment funds has come from Americans. There appear to be several reasons for this trend. One is Vietnam's improved legal and commercial system (including the recent promulgation of a strong securities law, reinforced by BTA implementation and WTO accession). Other important factors are expectations of rapid, sustained growth in Vietnam's economy and the more aggressive equitization of SOEs. Although the inflows of foreign money appear to be based on strong economic fundamentals, it raises prospects for problems—destabilizing speculative bubbles, corporate governance conflicts between

foreign and domestic equity owners, and damage to financial systems and macroeconomic stability. During the Asian crisis of the mid-1990s, such difficulties afflicted Vietnam's neighbors in the wake of large inflows of foreign funds, typically in the form of both indirect investment and loans. All of these introduce new concerns for Vietnam that will require much better data to track trends, as well as careful regulatory and policy management.

Foreign Investor Perceptions

Perceptions on factors affecting investment decisions were assessed by a survey conducted by Vietnam's Foreign Investment Agency (FIA) of 385 foreign-invested enterprises (FIEs) in 2006. These consisted of about 94 percent non-U.S. firms and 6 percent U.S. firms, and 68 percent industrial firms and 32 percent service providers, which are roughly representative of the full FDI population in Vietnam. Key findings include the following:

Foreign investors note the importance of BTA commitments—especially U.S. FIEs, all FIEs exporting to the United States, and all FIEs in service sectors. About half the FIEs surveyed reported that the BTA had an important impact on their investment decisions in Vietnam. The BTA's relative impact was considerably stronger on U.S. firms, all FIEs who exported to the United States, and all service providers, compared to non-U.S. firms, all firms who did not export to the United States (exported only to non-U.S. markets or did not export at all), and industrial firms (see Figures 22 and 23). Nonetheless, almost half of the non-U.S. firms—firms that would not be covered directly by the BTA—also reported that the BTA mattered. FIEs identified the following as the chief reasons the BTA was important to them: (i) the BTA acted as a stepping stone to the WTO; (ii) it created more business opportunities; (iii) it signified Vietnam's commitment to international rules; and (iv) it opened the U.S. market to Vietnam exports. U.S. investors were significantly more prone than non-U.S. investors to point to the BTA's role as a stepping stone to the WTO, as a sign that Vietnam was committed to international rules, and as setting treaty-bound, concrete schedules for administrative reforms and liberalized market access.

FIEs said that the most important BTA commitments for attracting foreign investment are (i) treating foreign and domestic investors equally (national treatment); (ii) opening more services to foreign investment; (iii) using simpler registration processes for establishing a foreign investment; (iv) improving transparency; (v) strengthening IPR protection; and (vi) removing WTO-inconsistent foreign investment requirements. U.S. firms placed relatively greater emphasis on having more open market access for services; improved transparency; and to a somewhat lesser degree more effective dispute settlement

and stronger IPR protection. But they saw removing WTO-inconsistent investment restrictions as considerably less important than did non-U.S. firms.

A similar analysis was done for FIEs in manufacturing versus services, with no breakdown by nationality. Service providers considered each element of the BTA to have played a much larger role in their own investment decisions than manufacturers did. For attracting FDI in general, FIEs in service sectors emphasized the following BTA commitments much more strongly than manufacturing firms did: (i) open service sectors; (ii) simple FDI registration procedures; (iii) improved transparency; (iv) stronger IPR enforcement; and (v) more effective dispute resolution processes. FIEs in service sectors appear to be considerably more sensitive to the BTA's systematic reforms than manufacturing firms.

Several factors were key in improving Vietnam's business environment.

FIEs ranked a number of factors as important for improving Vietnam's business environment (including both BTA and other factors), with the following ranked the highest: developing effective investment promotion programs; strengthening administrative reform and transparency; joining the WTO; improving the enforcement of laws; and improving access to credit by liberalizing the financial sector (see Figure 28). A second group of issues, considered only slightly less important, included simplifying investment licensing procedures; developing a predictable and effective tax system; opening more sectors to foreign investment; and removing inconsistencies among regulations. A third group—again, just slightly less important—included offering more investment incentives; improving infrastructure; concluding a tax treaty to avoid double taxation; and stronger protection of investor rights. Still important, but somewhat less so, was making it easier to acquire land.

U.S. firms reported that almost every issue was more important than did non-U.S. firms. U.S. firms ranked the following issues as most important: strengthening administrative reform and transparency, offering investment incentives, developing effective investment promotion programs, simplifying investment licensing procedures, removing inconsistent regulations, improving infrastructure, joining the WTO, concluding a taxation agreement, opening more sectors to foreign investment, and improving the enforcement of laws (including IPR laws). The strongest agreement between U.S. and non-U.S. firms was about the importance of joining the WTO and improving the enforcement of laws. Compared to non-U.S. firms, U.S. firms placed a substantially greater emphasis on availability of investment incentives, improving infrastructure, strengthening administrative reform and transparency, simplifying investment licensing procedures, removing inconsistent regulations, and concluding a taxation

agreement.

FIEs show strong overall performance since the BTA; exports were labor-intensive and strong generators of employment. The five years following BTA implementation have been a period of high performance for foreign-invested enterprises, with FIEs increasing exports, sales to domestic markets, investment, and employment quite strongly. This broad, consistently positive result would support the conclusion that the BTA was associated with a major improvement in the operating environment for FIEs in Vietnam. FIEs who exported tended to increase employment much more strongly than did non-exporters, reinforcing two conclusions: (i) that Vietnamese exports are labor-intensive and in line with its comparative advantage, and (ii) that export growth has contributed strongly to creating new jobs in Vietnam since the BTA. In general, FIEs exporting to the U.S. market expanded exports, investment, and employment more robustly than FIEs exporting only to non-U.S. markets or non-exporters. This would suggest an even more directly positive impact of the BTA's opening of the U.S. market for Vietnamese exports. The one anomaly of interest is that FIEs exporting to the United States reported weaker business performance (profitability) than the other FIEs, possibly reflecting stronger competition and thus thinner profit margins in the U.S. market relative to other export or domestic markets.

CHANGES IN VIETNAM'S ECONOMIC STRUCTURE AND THE BTA

Vietnam's economy has become increasingly more oriented toward exports, labor-intensive production, and the private sector since the BTA. As economic theory would predict, the opening of the U.S. market for Vietnamese exports and the improvement in the domestic business environment following BTA implementation unleashed Vietnam's comparative advantage in labor-intensive economic activity. The result has been a shift toward more labor-intensive exports, output, investment, and employment. These trends mean that for each dollar/dong of output, export, or investment, more jobs were created by market-driven activity in Vietnam, achieving a key socioeconomic development objective. Moreover, during this period the center of gravity in the economy shifted away from SOEs toward private enterprises, both domestic and foreign.

THE IMPACT OF LIBERALIZING SERVICES

Service sectors have flourished after the BTA. A key concern in Vietnam when the BTA was being finalized was that its aggressive opening of Vietnam's

service sectors to U.S. firms would retard the development of Vietnam's fledgling service providers. This point of view saw services as a zero-sum game, in which greater foreign activity would mean less domestic activity. Anecdotal evidence from many service sectors suggest that development of Vietnam's services sectors has been, instead, a positive-sum game—foreign service providers have helped to raise the overall quality and quantity of service sectors throughout the economy, expanding opportunities for domestic service providers as well. For example, while foreign law firms, consulting firms, banks, insurance companies, and tourism and hotels have grown rapidly, Vietnamese firms in these sectors have flourished as well. Robust service sectors with strong foreign *and* domestic firms are rapidly becoming the norm in Vietnam, not the exception. Most importantly, consumers of services throughout the economy have benefited.

Reform in the banking sector is advancing; international experience shows liberalization typically leads to stronger domestic financial markets. Among the various service sectors, we look more closely at the banking sector. The full impact of liberalization of banking in Vietnam will not be known for several years later. Both the BTA and the WTO have strong requirements for increasing market access by foreign banks and moving toward national treatment of foreign and domestic banks, although some of these provisions are still to be phased in. After making initial reforms to comply with BTA and WTO requirements, Vietnam is planning to almost fully rewrite and modernize its regulatory system for financial market activity. These reforms will include major revisions to Vietnam's laws on the central bank and credit institutions, as well as the development of new laws on prudential supervision and deposit insurance. A strong new securities law with supporting regulations was recently promulgated. Plans are also in place to equitize the four major state-owned commercial banks.

Confidence in Vietnam's banking system has increased substantially over the last five years, as attested by the rapid expansion of deposits and lending in commercial banks. A survey of international experience reinforces the conclusion that market liberalization in the banking sector typically leads to stronger domestic financial markets.

CHAPTER 1
INTRODUCTION

This report assesses the impact of implementing the U.S.-Vietnam Bilateral Trade Agreement (BTA) on trade, foreign investment and economic structure over the five years following its coming into force on December 10, 2001. It particularly focuses on expanding bilateral relationships between the two countries in the context of the parallel and mutually reinforcing process of Vietnam's accession to the World Trade Organization (WTO), completed on January 11, 2007. The report is co-authored by research staff from the Vietnamese Ministry of Planning and Investment's Central Institute for Economic Management (CIEM), the ministry's Foreign Investment Agency (FIA), and the Support for Trade Acceleration (STAR Vietnam) project funded by the U.S. Agency for International Development (USAID). It builds upon similar reports completed by CIEM and STAR that analyzed the trade and economic impact of the first two years of BTA implementation. It also draws on a FIA-STAR report that examined the initial response of foreign direct investment to the BTA, using newly collected data on foreign direct investment (FDI) from overseas subsidiaries of U.S. firms to Vietnam.

A Note on Methodology

Any attempt to differentiate the impact of the BTA on trade and economic activity in Vietnam faces a fundamental challenge. Over the last five years, Vietnam has essentially rewritten its legal framework for commercial activity and judicial procedures. Some of these reforms were required directly by the BTA (e.g., a shift to customs valuation procedures, liberalizing foreign bank operations, and streamlining investment procedures). Others were needed to modernize Vietnam's laws to facilitate market activity (e.g., new contract law). Many others overlapped with requirements to finalize the WTO accession process (criminalization of commercial-scale infringement of intellectual property rights, or IPR, and elimination of certain subsidies). With so many interrelated changes occurring at once, it is not possible to isolate the impact of one reform versus the many others, especially given that a key BTA objective for both countries was to accelerate Vietnam's WTO accession process.

The BTA, however, did have one major, distinctive impact. By normalizing economic relations between the two countries upon entry into force, the BTA required the United States to extend NTR/MFN duties to imports from Vietnam, which effectively lowered average tariff levels from around 40 percent to 4 percent for Vietnamese exporters. The resulting surge in Vietnamese exports to the United States clearly occurred as a result of this policy change. Led by labor-intensive manufactured exports, the surge contributed importantly to the overall expansion and diversification of Vietnamese exports, the shift in Vietnam's economic structure away from capital-intensive and SOE-dominated production, and the creation of more employment per dollar of investment over this period, which are all quite positive results.

Similarly, overall and U.S. investment into Vietnam increased after the BTA came into force. Some initial expansion of FDI appears to be directly linked to the BTA, as largely Asian firms invested in Vietnam to build the capacity to export to the newly opened U.S. market. But investment expanded especially rapidly in 2005 and 2006, as the WTO accession negotiations neared their conclusion. And throughout this period of rapid growth, Vietnam continued to advance a number of other reforms not directly required by either trade agreement. All of these positive initiatives surely stimulated investor confidence.

In this report, therefore, we report trends in trade, investment, and economic structure that occurred over the first five years of BTA implementation, from 2002 to 2006. We compare these trends with pre-BTA periods. We also point out changes in economic activity over the last five years that appear to be related directly to BTA requirements. We do not attempt, however, to develop a model that could more carefully differentiate the impact of BTA-specific reforms from the many other policy changes that have occurred over this period. We are happy to make available all data used in our analysis, and we encourage further research to refine and clarify the findings of our study.

The Role of the USAID/STAR Project

Although this report focuses on the impact of the BTA on trade, investment and economic structure, it is part of a larger program of USAID/STAR technical assistance to support Vietnam's implementation of the BTA and accession to the WTO. As presented in more detail in the "USAID/STAR Close-Out Report," USAID/STAR's overall outputs over five years and five months of operation can be summarized as follows:

- **Laws Supported.** USAID/STAR provided tailored technical assistance, including detailed legal comments on often multiple drafts, to help rewrite or develop from scratch 93 laws and regulations, of which 69

were adopted by project close-out on February 15, 2007. Most of the remaining reforms still in development are expected to be approved over the next several years.

- **Seminars Supported.** USAID/STAR supported counterparts in organizing around 290 seminars and workshops for approximately 20,400 state officials and business leaders to promote reforms, to encourage feedback on draft legislation by stakeholders, to enhance understanding of BTA and WTO requirements, and to provide training to improve enforcement of the new laws.
- **Research Reports Published.** USAID/STAR worked with counterparts to produce a series of research reports that analyzed the impact of the BTA on Vietnam's trade, investment, economic structure, and legal system. The reports enhanced public understanding of the BTA and its largely positive impact on the Vietnamese economy while identifying remaining challenges.
- **Websites Supported.** USAID/STAR worked with four key counterparts to develop websites to increase transparency and encourage public feedback on legislative reforms, judicial processes, and administrative/regulatory procedures.
- **References Provided.** USAID/STAR worked with counterparts to develop and publish more than 58,000 copies of reference materials related to the BTA/WTO. The materials were distributed throughout Vietnam to government officials, National Assembly deputies and staff, judges, and prosecutors, as well as to Party and business leaders.
- **Study Missions Conducted.** Working closely in most cases with the U.S.-Vietnam Trade Council (USVTC), USAID/STAR organized 28 study missions for 180 officials to the United States, to Vietnam's Asian neighbors, and within Vietnam. To enhance understanding and support for key BTA/WTO-related reforms, these were carefully targeted to help government leaders gain firsthand knowledge of how other countries (or local provinces in Vietnam) were handling key issues related to BTA/WTO compliance.

In recognition of the productive partnership between the USAID/STAR Project and the Vietnam agencies responsible for successfully implementing the BTA and acceding to the WTO, Vietnam's President Nguyen Minh Triet and U.S. President George W. Bush explicitly noted the key role played by USAID/STAR in a joint communiqué following President Bush's state visit to Vietnam in November 2006.

Overview of the Report

Chapter 2 reviews BTA requirements and the reforms made by Vietnam to implement the agreement successfully. It puts the BTA in the broader context of the more systematic reforms made by Vietnam to modernize its economy and to meet requirements for WTO accession. Chapter 3 focuses on the impact of the BTA on bilateral trade between the two countries over the last five years, within the context of overall Vietnamese trade flows. Chapter 4 provides a similar analysis on the impact of the BTA on foreign and U.S. investment into Vietnam, using new data collected by the FIA that identifies foreign direct investment made by overseas U.S. subsidiaries and data collected on recent indirect investment flows. Chapter 5 reports on the findings of an extensive survey of foreign investors conducted by the FIA in 2006, which probed perceptions on the importance of the impact of the BTA and Vietnam's broader reform efforts on foreign investment decisions and foreign-invested-enterprise performance. Chapter 6 provides an initial analysis of changes in Vietnam's economic structure, both in terms of output and employment, that occurred after BTA implementation.

Given concerns among many Vietnamese that opening service sectors to foreign competition may retard the development of related domestic capacities, we look carefully in Chapter 7 at the evolution of the banking sector in Vietnam over the last five years. This chapter includes a review of the literature on recent international experiences regarding the impact on domestic banking sectors of opening market access to foreign banks.

We stress that while this report is designed to evaluate key trends and linkages between the BTA and economic activity in Vietnam, it leaves many questions open for more in-depth analysis that we hope to pursue over the next several years. We hope that this report encourages others to pursue these issues further as well.

CHAPTER 2

BTA IMPLEMENTATION

Vietnam and the United States took a major step toward normalizing economic relations when the BTA came into effect on December 10, 2001.¹ After years of intensive negotiations starting in 1995, the BTA represented by far the most comprehensive bilateral trade agreement ever negotiated by Vietnam, and was fully in line with similar trade agreements negotiated by the United States with other developing countries. The BTA was built on a framework of international best practice incorporated in WTO agreements and other international conventions and agreements that have been developed to govern global trade and investment relations. As such, it was designed by both countries to serve as a “stepping stone” to Vietnam’s WTO accession—accomplished when Vietnam became the WTO’s 150th member on January 11, 2007.

The BTA, much like the WTO, is a “modern” trade agreement, in the sense that it includes extensive obligations related not just to import tariffs and quotas, but also to transparency, dispute settlement, investment, intellectual property protection, market access for services, and business facilitation. The BTA consists of well over 100 pages of text and tables, including extensive obligations for both parties, elaborated in six chapters on trade in goods; intellectual property rights; trade in services; development of investment relations; business facilitation; and transparency-related provisions and right

1. The U.S. lifted its 19-year-long trade embargo on Vietnam in 1994, and the two countries normalized political relations in 1995. Negotiations on the BTA started in 1995 and were concluded initially by the negotiators in 1999. After further discussion and exchanges of letters, the Agreement was signed on July 13, 2000. The BTA was ratified by the U.S. Congress in October 2001 and then by Vietnam’s National Assembly in November 2001. The U.S. fully normalized economic relations with Vietnam when President Bush extended permanent normal trade relations in December, 2006, following a key authorization vote by the U.S. Congress. Vietnam also initiated its negotiations to accede to the WTO in 1995 and signed on to implement preferential tariff reductions to 0 to 5 percent through the ASEAN Free-Trade Agreement (AFTA) that year.

of appeal, followed by a seventh chapter of general articles.¹

Both governments committed to fully implement all of their obligations under the BTA. As a developed country and founding member of the WTO and the General Agreement on Tariffs and Trade (GATT), whose laws and regulations already complied with international best practice, the United States met all its obligations when the BTA came into effect by giving Vietnam NTR/MFN (Normal Trade Relations, formerly Most Favored Nation) trade status.² This reduced the average U.S. tariff rate for Vietnamese exports to the United States from around 40 percent to around 4 percent.

Vietnam, on the other hand, entered into the BTA with a legal and policy system that was still heavily influenced by its previous system, with its emphasis on centrally-planned, state-dominated economic activity. As a result, it had to make extensive changes in its laws, regulations, and administrative procedures to come into compliance with the international standards incorporated in the BTA. A Ministry of Justice report estimated that close to 100 laws and regulations had to be rewritten or developed anew to meet BTA requirements. The BTA also required Vietnam to open market access to U.S. firms for more than 20 service sectors and other investment sectors, to lower MFN duty rates on 261 tariff lines, and to eliminate almost all import quotas.³

1.The English text of the BTA, with accompanying side letters, is available on the USTR webpage (www.ustr.gov). The Vietnamese language text is published in the Official Gazette of the Vietnamese Government.

2.The United States did need to change circuit board protection in Articles 3 and 8 of Chapter II on IPR Protection in the BTA. The change was required 14 months after the BTA took effect.

3.Tariff reductions were applied on an NTR/MFN basis, with cuts typically between 20 to 50 percent per line. They were applied in large part after three years of BTA implementation, predominantly on agricultural products. When Vietnam conformed to the Association of Southeast Asian Nations (ASEAN) tariff schedule in September 2003, it increased the number of its tariff lines from around 6,500 to around 10,700. The BTA tariff cuts now represent, therefore, roughly 4 percent of all agricultural lines, and 1 percent of non-agricultural products (see USVTC, 2004). Annex B of the BTA provides a list of several hundred tariff lines where import quotas were to be eliminated. In most cases quotas were to be ended over periods of 2 to 10 years; with most ended in 4–7 years. Actually, few of these products faced import quotas in practice as the BTA came into force, but the BTA did forbid their application in the future. In line with an agreement with the World Bank and the IMF—as applied in the *Decision of the Prime Minister on Managing Exports and Imports in the 2001-2005 period*, No.: 46/2001/QĐ-TTg, April 4, 2001 - all import quotas except for sugar and petroleum products were to be eliminated by the end of 2002. The BTA called for the elimination of import quotas on sugar in 10 years and for many petroleum products in 7 years. Tariff rate quotas for some agricultural products, however, apparently remain in place.

This massive undertaking, however, did not have to be completed immediately. The BTA recognized that as a developing country, Vietnam needed time to make so many fundamental legal and institutional changes. Accordingly, while a number of Vietnam's commitments in the BTA were due immediately upon entry into force of the agreement, others were phased in over various time periods from one to 10 years, with most key legal commitments due by the second to fourth years following entry into force (Dec. 10, 2003 to 2005).¹

More specifically, in addition to limited tariff reductions and the elimination of most import quotas, Vietnam's BTA commitments required the following:²

- 1) **MFN and National Treatment Accorded to U.S. Companies and Nationals.** Vietnam committed upon entry into force to provide MFN and national treatment (NT) for most trade in goods and services from the United States and for investment relations as well, except for a moderate number of exemptions listed in various provisions and annexes of the agreement. National treatment (that is, treating foreign and domestic firms equally) was also provided for protecting IPR. In some cases, MFN and NT are phased in over time according to detailed timetables specified in the BTA.
- 2) **Customs System and Procedures Reformed.** Vietnam committed to

1. A number of important changes in Vietnam's legal and institutional structure were required upon entry into force, including requirements for transparency, the right to appeal administrative actions, dispute settlement (arbitration), and enforcement of existing IPR regulations. Processes to make the many BTA-related reforms, however, did not start until the BTA was approved by the National Assembly in late 2001. As a result, many of the "due upon entry into force" obligations were effectively phased in as well, given that it takes considerable time and effort to revise existing laws and regulations to make fundamental legal reforms. As key first steps in this process, Vietnam moved quickly to revise its "Law on Laws" to require that all laws, regulations and administrative procedures would become effective 15 days after being published in the Official Gazette, and to develop a BTA-compliant Ordinance on Commercial Arbitration. Most discriminatory pricing between domestic and foreign entities was removed quickly as well. Key reforms required in the first and second year were applied on schedule, including liberalizing Dong deposit holding limitations for U.S. banks and moving to a valuation system for customs processes. Progress in meeting deadlines was monitored closely through a BTA consultative arrangement headed by Vietnam's Ministry of Trade and the Office of the U.S. Trade Representative—the Joint Committee on Development of Economics and Trade Relations.

2. The following is not intended to provide a comprehensive review of BTA obligations; rather, it provides a summary of key obligations to highlight the breadth and depth of the types of policies affected by the BTA. See the "Summary of the U.S.-Vietnam Trade Agreement" produced by the U.S. Vietnam Trade Council's Education Forum and the Vietnamese Ministry of Trade for a more comprehensive summary of BTA obligations.

meet international/WTO standards for customs procedures, including a) shifting its tariff procedures from a system based on administrative prices to one using transaction values (by December 2003); b) making every reasonable effort to comply with international standards on a harmonized system of tariff classifications (by December 2002); c) applying these uniformly among all ports of entry; d) limiting all fees on customs procedures, not to exceed the costs of the services rendered (by December 2002); and e) establishing effective border measures to stop the import of materials infringing on IPR.

- 3) **Prohibition on Using Administrative Procedures and Technical Regulations for Protective Purposes.** Upon entry into force, the BTA committed Vietnam not to use administrative procedures and technical regulations to “create unnecessary obstacles to international trade.” The BTA required that Vietnam meet most of the obligations listed in the WTO agreements on technical barriers to trade (TBT) for industrial goods and SPS for agricultural and food products, the main difference being that the BTA did not require Vietnam to set up inquiry points.
- 4) **Liberalized and Streamlined Trading Rights.** The BTA required Vietnam, upon entry into force, to liberalize and streamline licensing procedures for import and export activities in line with the WTO Agreement on Import Licensing Procedures, subject to certain phased in sectoral limitations. Substantial liberalization in such trading rights for U.S.-invested firms was to be phased in from Year 3 (December 2004) to Year 7 (December 2008) after entry into force.¹ State trading activities must be conducted on a commercial basis upon entry into force.
- 5) **Commercial Dispute Settlement Procedures Upgraded.** Upon entry into force, the BTA committed Vietnam to allow commercial disputes with foreign elements to be settled by internationally recognized arbitration rules and to provide for effective means to recognize and enforce arbitral awards.
- 6) **IPR Protection Substantially Strengthened.** Vietnam committed to enhance substantially its legal framework, judicial procedures, and enforcement mechanisms in order to improve protection of IPR. This commitment covers copyright and related rights, patents, trademarks,

1. One of the most controversial issues in BTA implementation (and possibly in WTO implementation as well) has been the link between import rights and distribution rights. That is, it has been unclear whether a firm can import a good (a trading right?) and then distribute it to local markets (a distribution services right?).

trade secrets, industrial designs, encrypted satellite signals, layout designs of integrated circuits, and plant varieties. Vietnam agreed to enforce its existing laws on IPR upon entry into force of the agreement. Additional IPR obligations, which largely mirror those contained in key international conventions¹ and in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), had to be met over a period of time from month 12 (December 2002) to month 30 (June 2004) following entry into force of the BTA.²

- 7) **Liberalizing Trade in Services.** Vietnam committed to substantially market access for U.S. service providers in more than 20 sectors, including a) business services such as legal services, accounting/auditing, tax consulting, architectural, engineering, computer and related services, advertising, market research, and management consulting services; b) communication services such as telecommunication (value-added and internet, basic, and voice) and audiovisual services; c) construction and related engineering services; d) distribution services, such as wholesale, retail, and franchising services; e) education services; f) financial services, such as insurance, banking, and related services; g) health-related services; and h) tourism and travel-related services. Most of these commitments were to be phased in over a period from Year 2 (December 2003) through Year 7 (December 2008), although one extends to Year 10 (December 2011). To ensure that such reforms were meaningful, the BTA called for transparent and objective domestic regulations for services, with limitations on abuse by monopoly suppliers and buyers. It also included many key obligations of the WTO General Agreement on Trade in Services (GATS) and incorporated in full the GATS Annex on Telecommunications, the WTO Telecommunications Reference Paper, the GATS Annex on Financial Services, and the GATS Annex on the Movement of Natural Persons.
- 8) **Liberalizing and Safeguarding Foreign Investment.** The BTA

1. Specifically referred to in the BTA, these conventions are the Paris Convention for the Protection of Industrial Property (1967); The Berne Convention for the Protection of Literary and Artistic Works (1971); The Convention for the Protection of Phonograms Against Unauthorized Duplication of their Phonograms (Geneva Convention) (1971); The Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite (Brussels Convention) (1974); and The International Convention for the Protection of New Varieties of Plants (UPOV) (1978 or 1991).

2. See USVTC (2004, page 14) for a review of the relatively minor differences between BTA and WTO requirements for legal and administrative reform.

committed Vietnam to make a number of reforms that encouraged greater U.S. investment in Vietnam, including a) providing MFN or NT—whichever was better—for U.S. investors, with NT phased in over time with respect to corporate governance, pricing for certain fees and services, and the mortgage of land-use rights; b) streamlining investment licensing procedures, in particular shifting over time toward a registration system of investment licensing rather than an evaluation regime; c) non-discriminatory pricing; d) a range of safeguards for foreign investors, including guarantees against expropriation without due process, prompt and effective compensation, and the right to repatriate earnings; e) the elimination over time of trade-related investment measures (TRIMs) involving trade balancing, local content, and foreign-exchange requirements; f) the elimination of export performance and technology transfer requirements; g) the right to choose key personnel regardless of nationality, and the right of movement of management personnel into the country; and, h) providing investors with a choice of means and procedures for resolving disputes with the government, such as binding arbitration between the investor and the government (including through the International Center for Settling Investment Disputes, or ICSID). Many of these obligations were due upon entry into force, while others were phased in over a number of years, in one case up to nine years after entry into force.

- 9) **Enhanced Business Facilitation.** Upon entry into force, Vietnam committed to facilitate bilateral trade and investment relationships by providing nondiscriminatory and direct access to basic business activities, such as advertising, conducting market studies, participating in trade fairs, renting offices, and so on.
- 10) **Greater Transparency for Laws, Regulations, and Administrative Procedures.** Upon entry into force, the BTA required the prompt, regular publication in an official journal of all laws, regulations, and administrative procedures of general application, together with contact information, to be made readily available to the public before being enforceable. In addition, it required that Vietnam give U.S. nationals and the U.S. Government the opportunity to comment on draft laws, regulations and administrative procedures. This requirement applies at both the national and the local level.
- 11) **Developing a System for Appealing Administrative Actions.** Upon entry into force, the BTA required Vietnam to develop and maintain a system of administrative and judicial tribunals to provide the

opportunity for prompt review and correction of administrative actions related to matters covered by the agreement. All administrative actions had to be appealable to a court, and the parties had to be notified in writing of decisions on such appeals together with the reasons for them.

- 12) **Uniform, Impartial and Reasonable Application of the Law.** Upon entry into force, the BTA requires Vietnam to administer all laws, regulations, and administrative procedures of general application in a uniform, impartial, and reasonable manner. This applies at the national and local levels.

BTA obligations placed substantial demands on Vietnam's legal system. Effective implementation of the BTA presumed a legal framework, government administrative and regulatory processes, and a judicial system that could operate in line with international standards, including specific requirements on settling commercial disputes, protecting IPR, guaranteeing investors' rights, appealing administrative actions, and enforcing transparency throughout the legislative, legal, and administrative systems. Effectively meeting these commitments required Vietnam to upgrade the legal, procedural, institutional, and human resource capabilities of their legal, administrative and judicial systems. In parallel with and in mutual reinforcement to the implementation of the BTA and accession to the WTO, the Government of Vietnam initiated major programs for broader legal and judicial development, public administration reform, and anti-corruption. In this way, just as the BTA served as a stepping stone for Vietnam's accession to the WTO, it also served as a major catalyst for even broader systematic reforms in the Vietnamese legal and governance systems. These steps promoted Vietnam's goal of establishing a socialist rule-of-law state and a socialist-oriented market economy, while promoting private-sector development.

Furthermore, for domestic and foreign businesses, workers, farmers, and consumers to benefit fully from the pro-market reforms required by the BTA and WTO, Vietnam had to modernize and strengthen its basic market laws and institutions. Private actors wanting to transact, invest, and innovate in a market economy need legal frameworks for the establishment, operation, and exit of firms, as well as for basic property rights, contract enforcement, financial instruments and securities, secured transactions, and protection from anticompetitive practices. Thus as part of Vietnam's broader, systematic effort to complete its transition from a centrally planned to a market-oriented economy, the government carried out a number of additional reforms that were not required directly by the BTA. Parallel to and coordinated with those directly required by the BTA, these reforms included (i) major improvements in procedures to establish private firms and to file for bankruptcy; (ii) a major reworking and modernization of contract law; (iii) establishment of a user-

friendly registration system for secured transactions; (iv) development of a stronger legal system for the use of bills of exchange, promissory notes and letters of credit; (v) much stronger regulations for corporate governance and for issuing and trading securities; (vi) clarification of the system of land-use rights; (vii) adjustments to bankruptcy procedures; and (viii) establishment of procedures to protect against anticompetitive market abuse and unfair trade practices in domestic and foreign markets.

Table 1 overviews many of the most important legal reforms completed to meet BTA requirements, both directly and indirectly, from 2002 to 2006.

Table 1: Key BTA-Related Legal Reforms Completed (2002–2006)

Five Years Ago	Situation Now	Reforms Completed
No legal framework for non-discrimination between foreign and local firms; dual pricing for foreign firms in place	New regulations on NT and NTR/MFN treatment in place; dual pricing for foreign firms eliminated	Ordinances on NT and MFN treatment; various regulations affecting dual pricing
Standards and technical regulations for goods incomplete and processes opaque	Procedures for voluntary product standards and mandatory technical regulations transparent, participatory, and in line with international standards	Law on Standards and Technical Regulations; Law on Quality of Goods
Custom valuation based on administrative prices	Custom valuation based on transaction values, with post auditing requirements	Laws on Customs and Export - Import Duties and implementing regulations
Import trading rights limited and procedures unclear	Trading rights procedures streamlined, but as of 2006, still uncertainties about import trading rights	Implementing regulations for revised Commercial Law
IPR regulations incomplete and ineffective Border measures against imports of IPR-infringing products weak	First comprehensive IPR law is in place Border measures strengthened in line with BTA requirements, implementation requires further improvement	Law on IPR Implementing regulations for the Law on Customs and inter-ministerial circulars with IPR agencies
Not a member of International Union for the Protection of New Varieties of Plants (UPOV) or of Brussels or Berne Conventions	Now a member of UPOV, Brussels, and Berne	Law on IPR; Ordinance on Seeds

Five Years Ago	Situation Now	Reforms Completed
Many restrictions on foreign participation in services	Fewer restrictions on foreign participation in services, including for legal, banking, and insurance services; remaining unresolved issues on liberalization of telecom and distribution sectors	Law on Lawyers, Law on Credit Institutions, Law on Investment (2005)
Different regimes for different types of investment; all FDI must be evaluated to receive a license; weak access to arbitration processes on investment disputes; weak investment protections	Common investment and enterprise laws for all types of investment (foreign, state, and private); licensing by registration for FDI under VND 300 billion (US\$18.75 million) in unrestricted sectors; stronger access to international	Law on Investment (2005), Law on Enterprises (2005)
Local-content and other investment performance requirements were inconsistent with TRIMs and other BTA requirements	arbitration, but not yet accession to ICSID; strengthened protections against nationalization and expropriation All required TRIMs and export performance requirements now eliminated; legal framework for technology transfer improved; performance requirements ended	Law on Investment (2005), Law on Technology Transfer
Commercial court procedures outdated, especially with regard to IPR requirements and commercial dispute settlement; court decisions hard to enforce	Modern court procedures adopted, including the use of emergency measures; court system unified at the national and local levels; judgment enforcement processes still not strengthened	Civil Procedure Code; Law on Organization of the Courts
Final administrative decisions not appealable to the court	Final administrative decisions now appealable at all stages to the court, with due process and written judgments	Law on Complaints and Denunciations; Ordinance on Settlement of Administrative Decisions
Ineffective rules for commercial arbitration and enforcement of awards	Arbitration rules liberalized and modeled on the UN Commission on International Trade Law (UNCITRAL) Model Law, especially for foreign elements and foreign-invested firms	Ordinance on Commercial Arbitration, Commercial Law, Investment Law (2005)

Five Years Ago	Situation Now	Reforms Completed
Not all laws and regulations published, at either national or local levels Draft laws and regulations not published	Legal normative documents are published 15 days before entry into force at the national level, with publication or posting required at the provincial and local levels Many draft laws and regulations published on website of Vietnam Chamber of Commerce and Industry (www.vibonline.com.vn) and state agency websites	Law on the Promulgation of Legal Normative Documents (Law on Laws); and the Law on Local Laws
Court decisions not published	Some court decisions have been published	Publication of court decisions by the Supreme People's Court
Weak securities regulations unable to support major growth in capital markets	Securities regulations consolidated, modernized, and systematized into one law	Securities Law*
Trade-remedy procedures not in place	New WTO-consistent procedures established for antidumping and countervailing-duty actions	Ordinance on Antidumping,* Ordinance on Countervailing Duties*
Limited legal framework to protect against market abuse and unfair trading practices	New regulations and procedures for protecting against predatory market and unfair trading actions	Competition Law*
Use of basic financial instruments such as bills of exchange limited because of poor regulations	Regulations in line with international best practice established for bills of exchange and promissory notes, which further facilitates the use of letters of credit	Law on Negotiable Instruments*
Difficult to secure movable assets as collateral	An improved legal framework for secured transactions was put in place	Civil Code, Decree on Secured Transactions*
Bankruptcy procedures ineffective	Procedures for bankruptcy improved, but still rarely used	Law on Bankruptcy*
Legal framework for land rights ownership unclear and not implemented uniformly	Improved regulations for land ownership and the use of land as collateral, including for foreigners, but uncertainties remain	Land Law*

Five Years Ago	Situation Now	Reforms Completed
Implementation of treaties into domestic law not clear	Clear procedures for implementing treaty requirements into domestic law in place, used to ratify the WTO Accession Protocol using an "omnibus-like" law to make final adjustments to several laws at once	Law on Treaties*

* In large part, changes in this law or regulation was not required directly by the BTA, but helped indirectly to implement the BTA by facilitating market activity that was needed to achieve BTA objectives.

Further Legal and Institutional Reforms Are Needed to Fully Implement the BTA. Full and effective implementation of the BTA involves not only changing the letter of the law, which in large part has been completed, but also critically requires that these legal reforms be implemented and enforced effectively on the ground, in practice. The institutional and administrative changes needed to improve enforcement of the many new laws have been started, but much remains to be done. Vietnam has placed administrative and institutional reform, including anti-corruption efforts, as a priority for the next five years. In addition to the recently promulgated Law on Anti-Corruption, new laws are needed to improve basic governance and rule-of-law procedures to facilitate implementation of the BTA and WTO requirements, in particular, and the effective operation of market institutions more generally. The following legal reforms are expected to be developed over the next several years, for application nationally and locally: a) a full modernization of the government administration system, including a new Law on Administrative Procedures to require transparency, accountability, and due process for administrative and regulatory procedures, with stronger processes for appealing disputes against government administrative actions through a new Law on Complaints, a new Law on Administrative Tribunals, and a new Law on Procedures for Settling Administrative Cases; b) revisions to the Law on the Organization of the Supreme People's Court; c) revisions to the Law on the Organization of the Supreme People's Procuracy; d) revisions to the Law on the Organization of the National Assembly; e) revisions to the Law on the Promulgation of Legal Normative Documents, which may integrate transparency requirements at national and local levels.

Arms-length regulatory procedures will need to be developed in many sectors, as the state moves away from direct ownership and administration of the

economy toward the facilitation and indirect regulation of those sectors in the public interest. The administrative processes noted above will be vital, but specific sectors and activities will require focused attention. Expected sector-specific reforms include (i) improvements in financial market regulation procedures through major revisions to the Law on the Central Bank and the Law on Credit Institutions, as well as the development of new laws on prudential financial supervision and deposit insurance; (ii) improvements in regulation of the telecommunication sector through a new Law on Telecommunications; and (iii) effective management of the new Ministry of Finance holding company for government ownership shares of commercial enterprises and effective equitization and rationalization of state-owned enterprises (SOEs). An ongoing Customs Modernization Program, which will include a major investment to develop an integrated information technology system, should greatly improve customs administration. National and provincial programs to improve IPR enforcement are being developed.

The BTA as a Stepping Stone to the WTO

The BTA was designed by both governments to be a “stepping stone” toward WTO accession, building upon the WTO agreements and related international conventions that incorporate international best practice for global trade and investment. As a result, most of the legal and administrative reforms required for WTO accession were initiated as part of the BTA implementation. The success of the BTA implementation process over five years of increasingly intense WTO negotiations (2002–2006) greatly raised Vietnam’s credibility as a country that stood by its international commitments. Furthermore, as an evolving requirement for WTO accession, almost all of the WTO requirements for legal and administrative reform had to be in place before accession was approved by WTO members. This made the “head start” provided by the first five years of BTA implementation all the more important. Since the BTA, like the WTO, binds these obligations by treaty, any backtracking on policy was much less likely.

The legal and administrative requirements for the BTA and WTO are not identical, however.¹ The BTA included stronger requirements for investment procedures and protections, corporate governance, and several areas of IPR. And

1. Vietnam’s WTO accession obligations for legal, administrative, regulatory and judicial reform are represented in its WTO Working Party Report on Accession of Vietnam; its market access obligations in trade in goods and services are in the accession schedules for tariffs and services. These are available in English on the WTO website and the U.S.-Vietnam Trade Council (USVTC) website, and in English and Vietnamese in the National Committee for International Economic Cooperation (NCIEC)/STAR Report on Vietnam’s WTO Accession Documents (2006).

the WTO included stronger requirements than the BTA in a number of areas, including i) eliminating trade-related industrial production and investment subsidies (over a five year period, except for the apparel and textile sector, which had to be eliminated immediately upon accession) and WTO-inconsistent agricultural subsidies,¹ limiting the role of state-led activities in the economy; ii) establishing inquiry points and reporting for standards and technical regulations (TBT) and sanitary and phyto-sanitary (SPS) regulations; and iii) liberalizing trading rights, including allowing companies without a presence in Vietnam to be an importer of record. The WTO also has stronger requirements for iv) antidumping, countervailing duty, and safeguard processes. The United States will be able to maintain non-market-economy requirements on its antidumping cases related to Vietnam for up to 12 years.

The most significant differences between the BTA and WTO, however, relate to market access obligations. The BTA broke critical new ground on a number of these issues, most profoundly in requiring major liberalization in market access to most services for the first time, as well as to a number of investment sectors. These requirements clearly set the tone for more systematic, long-term liberalization. However, as a bilateral agreement, the BTA required directly only that these sectors be open for U.S. service providers and investors, not all foreigners. Furthermore, as already noted, it required reductions in only about 261 tariff lines.² On the other hand, the WTO did not require trading partners to lower tariffs for Vietnamese exports, as the BTA did.

The BTA was taken as the starting point for negotiating further market access liberalization for trade in goods and services in the WTO accession.³

Tariffs and Quotas on Goods. The WTO Accession Agreement requires that Vietnam bind most of its tariffs with the WTO. It will reduce its overall current average of bound tariffs from 17.4 to 13.4 percent over a seven-year

1. For agriculture, Vietnam can apply WTO consistent measures, including special and different treatment extended to a developing country and up to a 10 percent limit on support in the "amber box".

2. Since tariff cuts in the BTA had to be applied by Vietnam on an MFN basis to all WTO members, there was an obvious "free rider" element: the U.S. negotiated the cuts in a bilateral, reciprocal trade agreement, but third countries who made no concessions still benefited from the cuts. This explains why the BTA lowered so few tariffs and why the USTR focused on negotiating tariff reductions with Vietnam in the multilateral-based WTO accession negotiations.

3. Summary information used in this report on Vietnam's WTO accession commitments are based upon an introduction to the WTO Accession Documents in the NCIEC/STAR Report on the WTO by Vice-Minister of Trade Luong Van Tu, who led Vietnam's WTO accession negotiating team. It is supplemented by press releases from the WTO and USTR.

period.¹ The average tariff for agricultural products will decline from 23.5 to 20.9 percent after about five years, and for industrial products from 16.8 to 12.6 percent after five to seven years. Vietnam agreed to duty-free imports for products covered by the WTO's Information and Technology Agreement, and will lower tariffs to zero or close to zero for many products covered by the Chemical Harmonization Agreement, the Agreement on Trade in Civil Aircraft, and for construction equipment, medical equipment and pharmaceuticals. These sectoral agreements will be implemented over a three- to five-year period. After full implementation of the WTO tariff cuts, most imports will face tariffs less than 15 percent—other than a few exceptions, bound tariffs will be between 0 and 35 percent. All import quotas will be eliminated. Vietnam, however, reserved the right to maintain tariff quotas on four products—sugar, eggs, unmanufactured tobacco and salt. The agreement allowed to restrict several sensitive products, including tobacco, petroleum products, cultural products and aircraft, to state traders, effectively permitting quantitative restrictions. Vietnam made commitments, in some cases phased in over three years, to eliminate discriminatory aspects of its excise tax regime, of particular importance for alcohol products. Vietnam was allowed to maintain export controls on rice.

Restrictions on Services. Vietnam made substantial commitments to liberalize access to 110 service subsectors included in 11 overall service sectors, out of 155 service subsectors identified by the WTO.² For most of these services, Vietnam will allow 100-percent foreign ownership (as is already the case currently), but restrictions limiting foreign ownership 49–65 percent will be maintained during several phase-in periods and will continue permanently for several other sectors, such as telecommunications.

Service sectors where WTO requirements are stronger than those of the

1. This represents the reduction of rates that have been bound with the WTO. In practice, Vietnam's applied tariff rates can be less than the WTO bound rate, so that the reduction in actual rates may be less. This means that the actual increase in market access will be less than implied by the reduction in the bound tariff rate required for WTO accession. Critically, however, rates bound with the WTO cannot be increased, whereas as lower applied rates may be adjusted as long as they stay below the relevant WTO bound rate.

2. The eleven overall service sectors include: 1) business services; 2) communication services; 3) construction and related engineering sectors; 4) distribution sectors; 5) education services; 6) environmental services; 7) financial services; 8) health related and social services; 9) tourism and travel-related services; 10) recreational, cultural and sporting services; and 11) transport services. As is the case for tariffs, in a number of cases, Vietnam may negotiate a certain requirement on liberalization for a service, even though in practice, foreign access to that service may already be allowed in practice. Again, this would give Vietnam the flexibility to adjust "applied" access limits for service sectors up to the bound WTO level. For most except the most sensitive sectors, the final WTO bound rate for services will allow 100 percent foreign ownership.

BTA include: securities brokers; transport sectors; express delivery services; several telecommunication services; and insurance services.

Combined with U.S. approval of permanent NTR for Vietnam, Vietnam's WTO accession in January 2007 did have one important impact on market access for Vietnamese exports—the United States revoked quotas of about 7 percent per year on imports of textiles and apparel from Vietnam. The United States had already eliminated such quotas for WTO members at the beginning of 2005, as required of it and all other WTO members.¹ Given Vietnam's highly competitive apparel sector and the receptivity and importance of the U.S. market, the elimination of the U.S. textile quota represents a major market opportunity for Vietnam. This may, however, be offset somewhat by the new U.S. textile monitoring mechanism, which may cause Vietnamese apparel exporters to restrain export growth.

Overall, therefore, with regard to market access, the BTA should be expected to have a greater direct impact on Vietnamese exporters, while the WTO will have a greater direct impact on increasing competition from importers in Vietnam's domestic market. In other words, the BTA opens the U.S. market to Vietnamese exports, while the WTO opens Vietnam to exports from other countries. The WTO does, importantly, provide Vietnam with equal access to WTO dispute resolution procedures, which should boost the confidence of Vietnam-based exporters.

In summary, over the last 20 years, but particularly since the coming into force of the BTA in 2001, Vietnam has steadily shifted its development strategy toward a market-oriented economy with a growing private sector and increased integration into global markets. Vietnam has used trade agreements as an integral part of a more systematic mix of reforms and initiatives to achieve its goals of becoming a mid-level-income developing country by 2010 and approaching a developed country by 2020. The BTA and the WTO have had an amazingly deep impact on many of the key elements of this new strategy, including not only reducing barriers for foreign trade and investment, but also developing a legal, regulatory and administrative system that is more transparent, more rules-based, with more effective state institutions and stronger and more independent courts. The BTA and WTO are viewed in Vietnam as milestones in its long-term development strategy. Its ultimate long-term impact, however, will depend on whether Vietnam views the BTA and WTO as a key element of continuing reform and modernization over time, not as the end of its liberalization and

1. Quotas on Chinese imports of textiles and apparel into the U.S. were subsequently re-established as part of a safeguard arrangement following a surge in Chinese exports after the elimination of the ATC.

reform efforts.

CHAPTER 3
THE TRADE IMPACT OF THE BTA

As discussed in Chapter 2, the principal obligation of the United States under the BTA was to grant Vietnam NTR/MFN status upon the entering into force of the agreement. The consequence of this action was to lower the average tariff on U.S. imports from Vietnam from an average of 40 percent to 4 percent, essentially opening the vast U.S. market to Vietnamese exporters literally overnight. Particularly significant were tariff cuts on labor-intensive manufactured products, in which Vietnam has a strong comparative advantage. As the following review of bilateral trade indicates, Vietnam's exports to the United States responded dramatically to the improved access to the U.S. market. Indeed, since the BTA went into effect, the United States has gone from one of Vietnam's smallest export destinations to become its single largest export market.

Vietnam, for its part, was not required to make significant cuts in tariffs on imports from the United States, cutting rates for only 261 tariff lines. There was, therefore, no reason to expect that the growth of U.S. exports to Vietnam would accelerate anywhere nearly as dramatically as did Vietnam's exports to the United States. However, while Vietnam was not required under the BTA to make significant tariff cuts, it was required to thoroughly reform its commercial laws and regulations. Furthermore, Vietnam agreed to significantly improve market access for U.S. firms in key service sectors, including banking, insurance, telecommunications and distribution, though the opening up of these sectors was phased in over a period of up to 10 years and is still not fully complete. These reforms would be expected to have a more direct impact on U.S. investment into Vietnam than on U.S. exports to Vietnam.

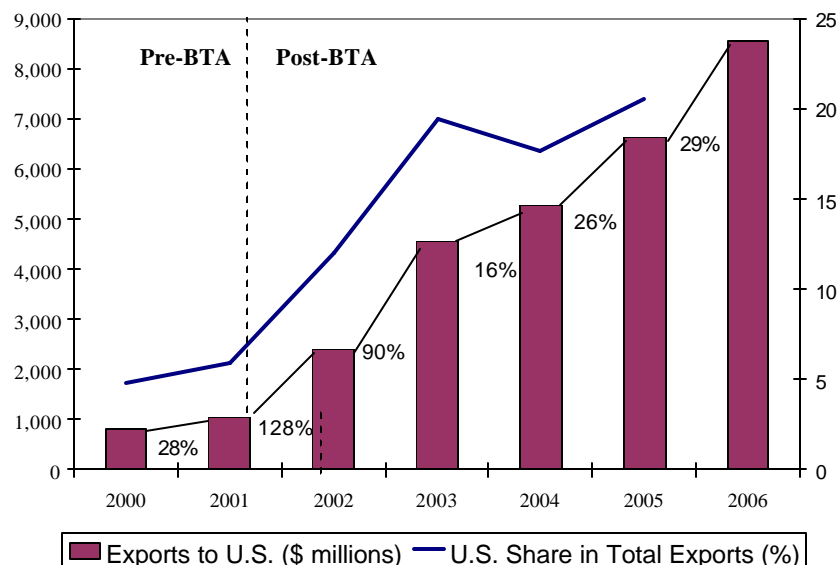
However, BTA-related improvements in the business environment, and the BTA's direct impact in expanding exports and FDI, have contributed materially to Vietnam's strong economic performance over the last five years. Annual real growth increased from what appeared to be a stable trend of around 7 percent to over 8 percent in 2005 and 2006. In just five years from 2002 to 2006, Vietnam's economy expanded by almost 50 percent. This stellar performance, in turn, increased demand for U.S. exports and FDI. Since the BTA, Vietnam has been one of the fastest-growing markets for U.S. exports and for FDI by U.S. firms. Thus, while one would not expect BTA implementation to boost U.S. exports to

Vietnam as explosively as it did Vietnamese exports to the United States, it was reasonable to expect that it would increase U.S. exports to Vietnam, and in particular, substantial expand U.S. FDI in Vietnam. And indeed that was the case, as the next two chapters show. Given skyrocketing Vietnamese exports to the United States, it is easy to lose sight of the positive trends on U.S. flows to Vietnam. The fact is that the first five years of BTA implementation led to a dramatic surge in bilateral trade and investment benefiting both countries.

A. GROWTH OF VIETNAM'S EXPORTS TO THE UNITED STATES

In our first reports on the economic impact of the BTA (2003, 2004), we highlighted the striking response in the first two years of the BTA to the opportunities the agreement created for Vietnam's exports. Vietnam's exports surged by 128 percent in 2002 and by another 90 percent in 2003 (see Figure 1 and Appendix Table). Just two years after the agreement came into force, the United States went from being a relatively small market for Vietnamese exports to become Vietnam's single largest export market, and has remained so since then. The export surge ended in 2003, however, with the implementation of the U.S.-Vietnam Textile Agreement and its limitation on apparel export growth. After 2003, Vietnamese exports to the United States grew in line with overall exports, with the share of the United States in total exports leveling off at about 20 percent.

Figure 1: Values (US\$ millions), Rates of Growth (percentages), and Shares in Total Exports (percentages) of Vietnam's Exports to the U.S. (2000–2006)



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

B. THE ROLE OF CLOTHING EXPORTS TO THE UNITED STATES

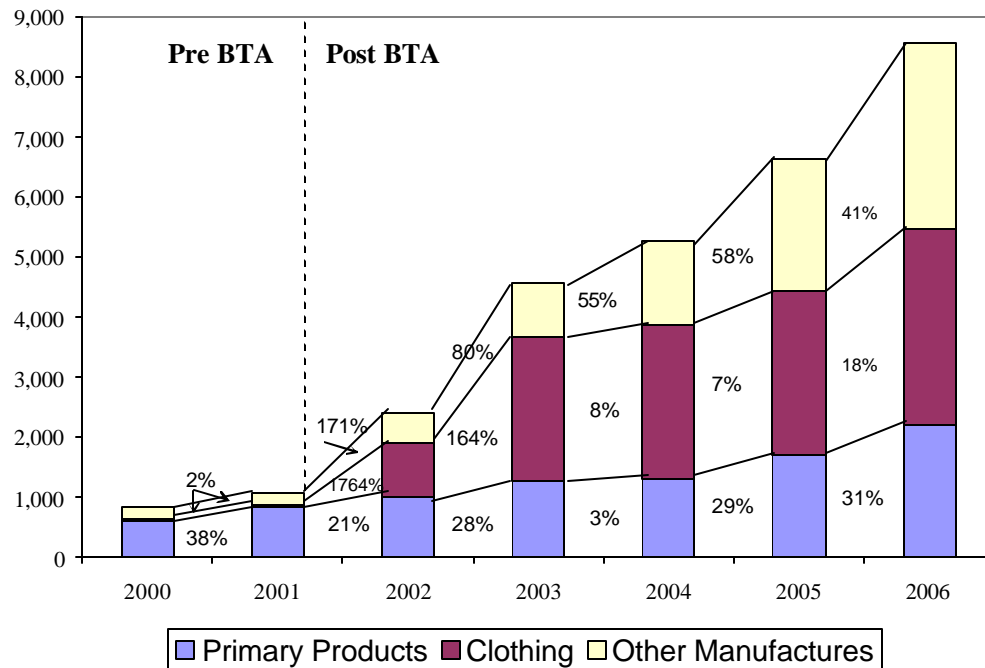
The initial surge in the growth of exports to the United States and the subsequent moderation in growth can be largely attributed to the performance of Vietnam's clothing exports (see Figure 2). For the first 18 months under the BTA, Vietnam's exports of clothing to the United States faced MFN tariff rates and no export quotas in the U.S. market. During that time, most of Vietnam's competitors were constrained by export quotas applied through the WTO's Agreement on Textiles and Clothing. During this period clothing exports to the United States expanded dramatically, rising almost 1,800 percent in 2002 and 650 percent the first six months of 2003 compared to the same period the previous year. The surge in clothing exports came to a halt in mid-2003 with the signing of the U.S.-Vietnam Textile Agreement, which effectively limited the growth of Vietnam's textile and clothing exports to the United States to 7–8 percent thereafter.¹

With Vietnam's accession to the WTO in January 2007 and the passage of Permanent Normal Trade Relations in December 2006, the United States eliminated quotas on Vietnam's textile and clothing exports in January 2007. The WTO agreement required that Vietnam eliminate immediately any export subsidies for textile and apparel exports and established an unprecedented tough, expedited enforcement monitoring mechanism to ensure fulfillment of the commitment to eliminate export subsidies over the first year following the accession.²

1. The formal title of this Agreement is the "Agreement Relating to Trade in Cotton, Wool, Man-Made Fiber, Non-Cotton Vegetable Fiber and Silk Blend Textiles and Textile Products Between the Governments of the United States of America and the Socialist Republic of Vietnam." The full text of the agreement is available on the Department of Commerce website: otexa.ita.doc.gov/#IMPORTQUOTAS. The agreement was signed on July 17, 2003, and applied retroactively to May 1, 2003. The agreement sets quantitative limits (not value limits) on exports of certain textile and apparel items, which altogether account for about 90 percent of textiles and apparel exported by Vietnam to the U.S. in early 2003. The working assumption in the agreement was that the export value allowed by quota in the base year of 2003 is approximately US\$1.7 billion. The agreement allows the quotas to be automatically extended to 2004 and beyond. Under the terms of the U.S.-Vietnam Textile Agreement, the export quotas are to continue until Vietnam joins the WTO or until its terms are revised in bilateral negotiations.

2. In addition, during the PNTR debate, the President established that he would consider "self-initiating" an antidumping action against Vietnamese apparel exporters if conditions so merited. See the USVTC website for a chronology of events and letters related to the WTO accession process.

Figure 2: Values (US\$ millions) and Rates of Growth (percentages) of Vietnam's Exports of Primary Products, Clothing, and Non-Clothing Manufactured Products to the United States



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

With the elimination of the quota and Vietnam's highly competitive apparel sector, it can be expected that Vietnamese exports of apparel to the United States will rise. An indication of how fast exports might increase can be provided by looking at the experience of other comparable exporters after the elimination of quotas on their imports in January 1, 2005 (see Table 2). It appears reasonable to expect that the value of Vietnamese exports of apparel to the United States will increase in the area of 20–30 percent over the next several years. Even with the quota still in place, the value of exports already began to increase substantially more than allowed by the 7 percent quantitative restriction in 2006, most likely because of a movement into higher-valued exports and growth in non-quota items.

Table 2: Growth Rates of Clothing Exports to the United States for Selected Countries
(SITC 84; percentages)

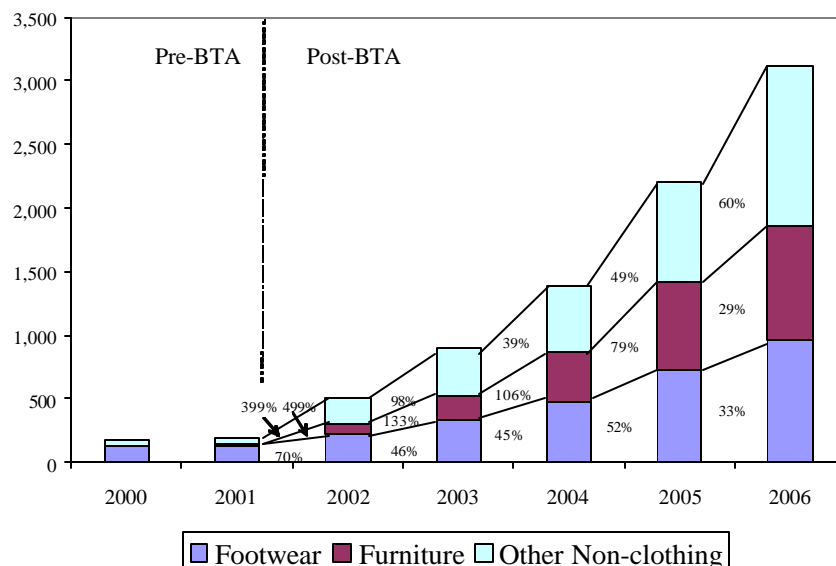
	2001	2002	2003	2004	2005	2006
Vietnam	2	1769	164	8	7	18
China	5	8	19	20	47	16
India	-3	7	5	10	32	6
Bangladesh	-1	-10	-2	7	20	23
Indonesia	8	-9	4	11	20	27

Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

C. DIVERSIFICATION OF MANUFACTURED EXPORTS TO THE UNITED STATES

While clothing was the dominant export to the United States in the first two years of the BTA, accounting for 52 percent of total exports and 67 percent of manufactures in 2003, since then non-clothing manufactured exports have grown most rapidly. The two largest non-clothing manufactured exports to the United States are footwear and furniture. As Figure 3 indicates, footwear was Vietnam's only significant manufactured export to the United States prior to the BTA and has continued to grow strongly since the BTA came into effect. By far the most dynamic non-clothing manufactured export to the United States, however, has been furniture, which reached a level of almost US\$ 900 million in 2006.

Figure 3: Values (US\$ millions) and Rates of Growth (percentages) of Leading Non-Clothing Manufactured Exports to the United States (2000–2006)



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

In addition to clothing, footwear, and furniture, Vietnam has begun to export a wide range of manufactured products. Growth in exports of these products in recent years has been quite high, albeit from a relatively low base. Among the more important emerging exports are data-processing machines, telecommunications equipment, travel goods, and miscellaneous manufactures, the later including plastic products, toys, and sporting goods (see Table 3).

In our previous reports, we noted that a key challenge for Vietnam was to expand its range of exports, especially of labor-intensive manufactured products. The recent trend toward greater diversification of exports to the United States, which is seen for overall Vietnamese exports as well, is a quite healthy sign that Vietnam's export capabilities are maturing. After decades of Vietnam's export structure being skewed toward primary exports, this trend brings Vietnam much more in line with the past experience of East Asia's "Tiger" economies. Taiwan, Korea, Thailand and China all began their export-led development approach with a concentration in clothing, and then diversified the product composition of their exports into a much broader array of labor-intensive manufactured products, and then steadily into more capital- and knowledge-intensive exports. The move into such exports accommodates, and indeed is propelled forward by, the success of economic development and rising real wages.

Over the last decade or so, the most dynamic export sector in East Asia has been electronics. Initially these exports were chiefly household and industrial electronic goods; more recently, computer and information technology electronics have predominated. The production of many electronic products is now organized within "regional production networks" where components for the final product are produced by many companies in many different countries, often on a contract basis rather than as part of a vertically integrated multinational firm. In these networks, divisions of labor tend to lower cost, time of delivery is critical ("just in time" inventory management), and technology development and adaptation is rapid—and is often shared within the network. If Vietnam continues to follow the track of its more developed neighbors, it can be expected to increasingly expand exports of electronics. Recent Vietnamese exports of electronics and computer parts illustrate this trend: they skyrocketed from US\$ 492 million in 2002 to US\$1.9 billion in 2006, driven largely by Japanese and Korean foreign investment.¹

1. See "Three Reasons for Strong Growth in Export of Electronics and Computer Parts", online *Vietnam Economic News*, June 11, 2007. Electronics exports, which were US\$492 million, US\$672 million, US\$1.1 billion, US\$1.4 billion, and US\$1.9 billion from 2002 to 2006, respectively, have grown considerably faster than overall exports. Electronics export growth has been 37 percent, 60 percent, 34 percent and 32 percent, compared to overall export growth of 21

This may not, however, mean that Vietnamese exports of electronics will surge to the United States, as apparel did. Many Vietnamese exports of components within these production networks will go to regional producers, expanding intraregional trade, even though the final product may be produced by a third country and ultimately exported to the United States.

An additional important consideration for electronics exports is that an Information Technology Agreement was negotiated in the Uruguay Round of WTO negotiations, which set tariffs at zero for most IT products. Moreover, trade remedy actions such as antidumping are rare in electronics. Thus, electronics is a sector with highly open market access throughout most of the world and with a mature and dynamic regional market in East Asia, which should allow rapid Vietnamese export growth with limited threat of antidumping or other trade remedies in importing countries.

Table 3: Selected Manufactured Exports to the United States

Items (SITC code)	Values in US\$ millions					Share in total mfg in 2006 (%)
	2002	2003	2004	2005	2006	
Total Manufactured Exports	1,400	3,280	3,966	4,944	6,357	100
Apparel (84)	900	2,380	2,571	2,738	3,239	51
Textiles (65)	13	38	67	59	76	1.2
<i>Made-up articles (658)</i>	7	23	48	41	76	1.2
Footwear (85)	225	327	475	721	960	15.1
Furniture (82)	80	188	386	692	895	14.1
Non-met. min. products (66)	20	28	32	40	51	0.8
Metal manufactures (69)	8	16	31	64	51	0.8
Power generating mach. (71)	4	14	22	21	23	0.4
<i>Electric motors (716)</i>	4	14	22	21	22	0.3
Electrical appliances (72)	5	4	3	6	6	0.1
Data processing machines (75)	17	62	49	108	188	3.0
<i>Auto data mach. (752)</i>	10	55	43	101	180	2.8
<i>Parts data mach. (759)</i>	6	7	6	7	8	0.1
Telecom apparatus (76)	1	7	12	38	104	1.6

percent, 31 percent, 22 percent and 23 percent, respectively, from 2003 to 2006. Electronics exports will continue to grow all the more rapidly once the Intel chip factory comes on line in Ho Chi Minh City.

Electrical mach. n.e.s. (77)	3	10	19	34	89	1.4
Road vehicles (78)	4	10	11	17	23	0.4
Travel goods (83)	50	86	110	114	116	1.8
Misc. manufactures (89)	28	49	92	158	247	3.9
Articles of plastic (893)	5	10	27	47	69	1.1
Toys & sports equip. (894)	16	21	24	41	60	0.9
Jewelry (897)	2	5	16	17	17	0.3
Misc. manuf. n.e.s. (899)	4	7	17	45	88	1.4

Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

D. PRIMARY PRODUCT EXPORTS TO THE UNITED STATES: THE ANTIDUMPING CHALLENGE

Vietnam's main exports to the United States prior to the BTA were primary products, accounting for almost 80 percent of total exports in 2001 (see Table 4). This excessive reliance on primary exports was a direct result of the market distortion caused by the lack of access to the U.S. market. Since the BTA came into effect, the share of primary exports in Vietnam's total exports to the United States has fallen to around 25 percent. Until world oil prices increased dramatically in 2004 through 2006, the single largest primary product export to the United States was fish and seafood. By 2006, petroleum exports became largest. In 2005, the foreign exchange earned from these two items was roughly equivalent, but in terms of employment, the export of fish and seafood products created far more jobs than did petroleum exports.

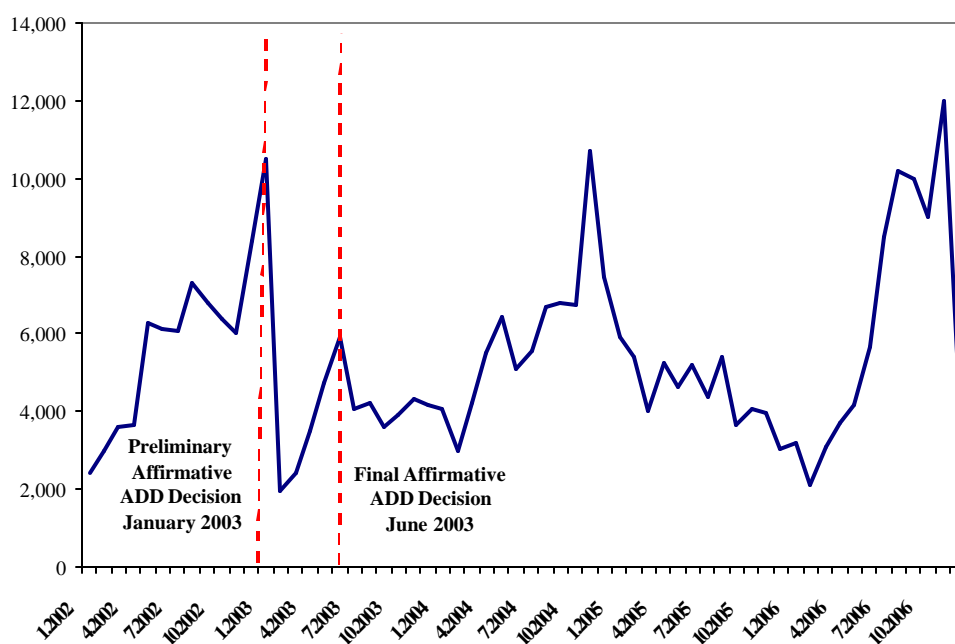
Table 4: Primary Product Exports to the United States (2001–2006)
(US\$ millions)

Item (SITC code)	2001	2002	2003	2004	2005	2006
Primary Products (0 to 4)	820	994	1,275	1,310	1,686	2,209
Fish & seafood (03)	478	616	732	568	630	653
Vegetables & fruit (05)	50	76	106	184	179	186
Coffee (071)	76	53	76	114	157	204
Crude rubber (231)	3	11	13	17	23	31
Petroleum (333)	183	181	278	349	605	1,036
Other primary exports	30	57	70	78	92	99
Share of Primary in Total Exports to the U.S. (%)	78	42	28	25	25	26

Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

Vietnam's two major fish and seafood exports are frozen fish fillets, mainly fillets of *basa* and *tra* fish (otherwise known as "catfish"), and frozen shrimp. Both of these products have become subject to U.S. antidumping duties.¹ These duties were applied to frozen fish fillets in January 2003, when the U.S. Department of Commerce made a preliminary affirmative determination of dumping. The final affirmative determination was made in June 2003, with antidumping duty rates set at essentially the same rate as announced in the preliminary determination (31 to 64 percent). As Figure 4 shows, the imposition of antidumping duties in January 2003 had a significant negative impact on exports of frozen fish fillets to the United States—the monthly export level fell from over US\$10 million to below US\$2 million. With the exception of spikes in late 2004 and 2006, Vietnam's exports of frozen fish fillets to the United States have stagnated since the imposition of the antidumping duties.

Figure 4: Monthly Exports of Frozen Fish Fillets to the United States (January 2002–December 2006) (US\$ thousands)



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

1. Since the U.S. Department of Commerce has designated Vietnam as a non-market economy, it uses a proxy country to evaluate whether Vietnamese export prices are below their costs of production. For basa and tra, Bangladesh was used, while for shrimp India was used. In both cases, it was determined that Vietnam exported products at prices substantially below costs.

Importantly, although antidumping duties clearly have imposed costs on Vietnamese producers and traders, they do not appear to have had a significant impact on total exports of tra and basa fish. Given Vietnam's strong competitive position in producing these products, Vietnamese exporters of tra and basa fish have been able to diversify exports to a number of other markets (see Table 5). In addition, to diversify their markets, exporters have diversified products, shifting from frozen fillets to higher value-added fresh fish fillets. As a result, the Ministry of Fisheries reports that the industry has maintained strong growth in sales, employment, and profits.

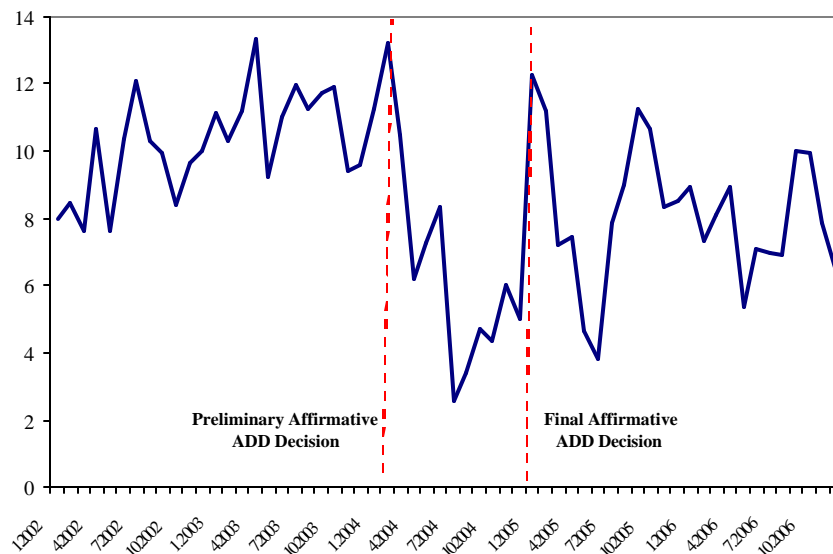
Table 5: Vietnam Exports of Tra and Basa Fish (tons)

	2000	2001	2002	2003	2004	2005
Total	1,129	1,737	27,987	32,876	83,844	141,011
U.S.	610	1,280	17,251	8,803	14,438	14,798
Other	519	457	10,736	24,073	69,406	126,213

Source: Report from the Ministry of Fisheries

Frozen shrimp is by far Vietnam's largest fish and seafood export to the United States. Until March 2004, as Figure 5 shows, Vietnam maintained a fairly constant share in total U.S. imports of frozen shrimp. The abrupt decline in Vietnam's share of the U.S. frozen shrimp market in February 2004 is directly related to the U.S. antidumping suit filed on December 31, 2003. This suit was against not only Vietnam's frozen shrimp exports, but included a number of other countries as well. On February 17, 2004, the U.S. International Trade Commission (USITC) made a preliminary affirmative determination of material injury to the domestic industry by reason of imports. Immediately thereafter, Vietnam's market share declined from 13 to 2 percent. On July 2, 2004, the U.S. Department of Commerce (US-DOC) made a preliminary affirmative determination of dumping by Vietnam, assessing a countrywide antidumping duty rate of 93.1 percent. It has been estimated, however, that about 80 percent of Vietnam's shrimp exports to the United States will be subject to company-specific antidumping rates of between 12 to 20 percent. As Figure 5 shows, both the USITC determination of injury and the US-DOC determination of dumping had significant negative impacts on Vietnam's shrimp exports to the United States. While Vietnam's exports of frozen shrimp partially recovered, Vietnam's market share in the United States remains significantly below the level achieved before the antidumping duties were imposed.

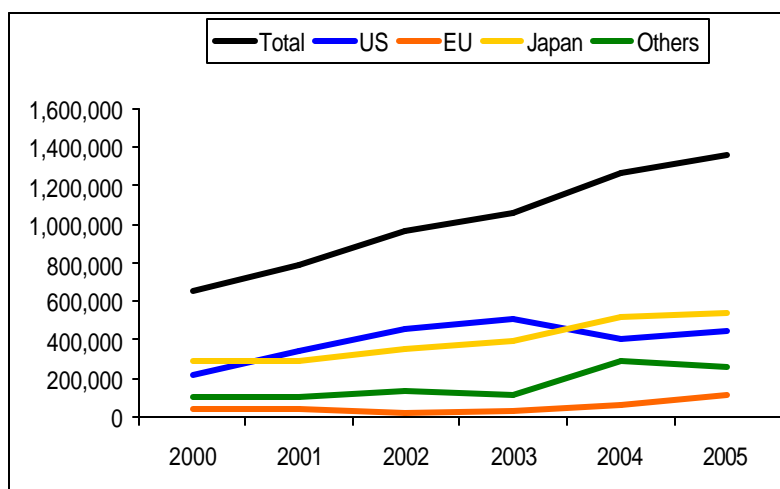
Figure 5: Vietnam's Share in Monthly U.S. Frozen Shrimp Imports (January 2002–December 2006) (percentage)



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

As with frozen fish fillet exports, although U.S. antidumping duties did impose costs on Vietnamese shrimp producers and exporters, it appears not to have had a major impact on the industry's overall performance. Export growth was maintained in 2005 by diverting exports to other markets, particularly Japan, allowing the industry to keep expanding sales, employment, and profits, according to reports from the Ministry of Fisheries (see Figure 6).

Figure 6: Vietnam's Exports of Shrimp (US\$ thousands)



Source: Ministry of Fisheries.

A key lesson in these antidumping cases is that Vietnam can continue to expand exports of products where they have a comparative advantage, even if market access in one country is restricted through a trade remedy action—and even if the restrictions are placed on such a major market as the United States. Antidumping cases impose costs on exporters. But growth in Vietnamese exports in general is ultimately determined much more by “supply-side” factors, where Vietnamese producers are efficient, low-cost producers, rather than by “demand-side” market access constraints related to tariffs or trade remedy actions by a particular country.¹ Many Vietnamese were concerned about systematic damage from antidumping activity following the initial antidumping ruling against frozen fish fillets. But these fears have been replaced with an understanding of the limited impact of a trade remedy ruling in one country on overall exports and that Vietnam can and should strive to export competitive products to many different markets throughout the world, diversifying risk rather than allowing excessive dependence on one particular market.²

E. SOLID GROWTH IN U.S. EXPORTS TO VIETNAM

Although the BTA is a bilateral trade agreement, there was no reason to expect a significant acceleration of U.S. exports to Vietnam as a result of the BTA, since the United States enjoyed MFN tariff status before the agreement was signed and the agreement did not require Vietnam to lower tariffs significantly on U.S. products. On the other hand, BTA-related improvements in Vietnam’s business environment and its impact on Vietnamese exports and FDI were expected to contribute to more rapid growth in the Vietnamese economy, which in turn could be expected to increase U.S. exports to Vietnam.

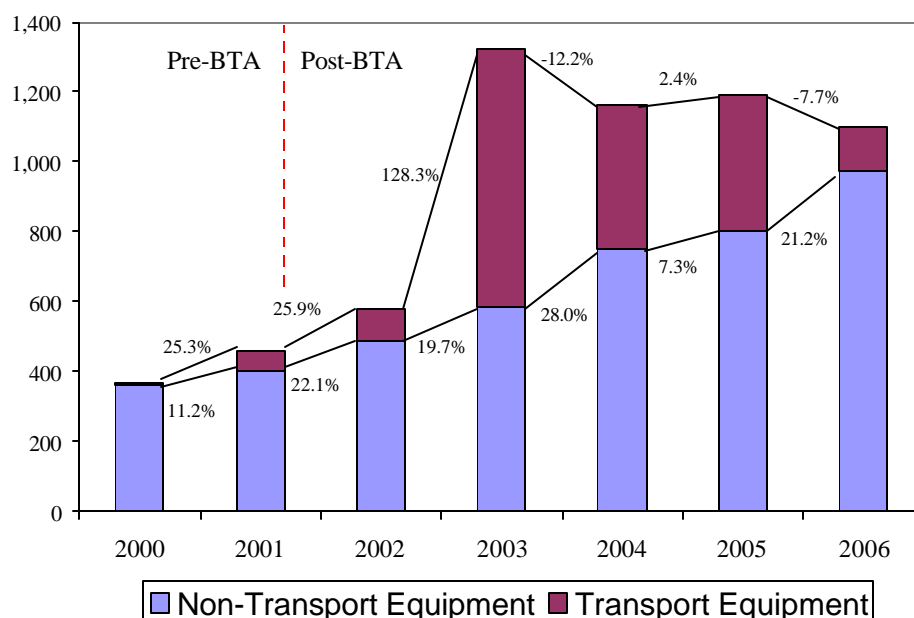
This proved to be the case. Although much attention has been placed on the surge in Vietnamese exports to the United States, U.S. exports grew by around 140 percent over the first five years of BTA implementation, making Vietnam one of the fastest-growing markets for U.S. exports worldwide over this period (see Figure 7). This has occurred partly because of the decision by Vietnam’s

1. After the initial shock of the antidumping cases, which some Vietnamese saw as a lack of good faith by the United States in their implementation of the BTA, it became clearer that trade disputes were, in fact, a sign of a more mature trading relationship. It was noted that the United States and Canada have quite a dynamic trading relationship-and a large number of trade disputes.

2. As well, it has heightened attention by Vietnamese exporters to market share thresholds for anti-dumping consideration and to consider the potential for anti-dumping cases when they set prices for their exported products, which in the later case, is made all the more complicated by its non-market economy status and the use of proxy countries to determine “market” costs.

national airline after the BTA came into force to purchase a number of U.S. commercial aircraft, so that their fleet would be made up roughly of half U.S.- and half EU-supplied aircraft. The sales of these big-ticket items (primarily Boeing 777s) contributed strongly to U.S. exports to Vietnam—in 2003 in particular, but also in 2004 and 2005. Even if the one-time bump in the export figures due to the transport/aircraft exports is excluded, however, U.S. exports to Vietnam rose about 20 percent a year during this period. U.S. exports are concentrated not only in transport equipment, but also in machinery, food, and other primary goods sectors (see Table 6).¹

Figure 7: Values (US\$ millions) and Rates of Growth (percentages) of U.S. Exports to Vietnam (2000–2006)



Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

1. Note that this analysis focuses only on trade in goods. Since the BTA requires Vietnam to expand market access substantially for U.S. service providers, it would be expected that U.S. exports of services to Vietnam have been increasing more rapidly than that of goods, but no data are available to verify this hypothesis.

**Table 6: The Commodity Composition of U.S. Exports to Vietnam
(2000–2006) (US\$ millions)**

	2000	2001	2002	2003	2004	2005	2006
Total Exports	367	460	580	1,324	1,163	1,191	1,100
<i>Primary products</i>	<i>68</i>	<i>106</i>	<i>120</i>	<i>141</i>	<i>223</i>	<i>283</i>	<i>339</i>
Food	37	49	49	48	82	126	144
Textile Fibers	16	30	30	39	73	54	62
Other primary	15	26	40	53	67	103	133
<i>Manufactures</i>	<i>299</i>	<i>354</i>	<i>460</i>	<i>1,182</i>	<i>940</i>	<i>908</i>	<i>761</i>
Fertilizer	29	19	26	24	1	13	1
Plastics & products	16	19	25	35	54	80	90
Paper products	7	17	16	21	23	17	18
Machinery	141	126	180	182	203	196	269
Transport equip.	8	60	91	739	415	388	126
Footwear parts	27	19	17	23	24	31	34
Scientific equip.	11	16	15	32	28	40	47
Other manufactures	58	75	88	125	191	141	176

Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

A continuation of 7 to 8 percent growth per year by the Vietnamese economy should be expected to support further strong growth in U.S. exports to Vietnam well into the future. U.S. exports to Vietnam should be spurred all the more by substantial tariff reductions in many key sectors where the United States has a strong competitive position, which will be phased in over the next five to seven years as a result of the WTO accession agreement.

G. BILATERAL TRADE IN THE CONTEXT OF OVERALL VIETNAMESE TRADE

The Impact of the BTA on the Geographic Distribution of Vietnam's Exports. In 2000, before the normalization of economic relations, the U.S. market accounted for around 5 percent of total Vietnamese exports, well below export market shares for other key trading partners such as the EU, Japan, and the Association of Southeast Asian Nations (see Table 7).¹ As described above,

1. Note that the data from Vietnamese sources do not match exactly bilateral trade data recorded from the U.S. International Trade Commission (USITC). This results primarily because of normal differences in reporting trade values by exporting and importing countries. Vietnam

with the extension of NTR/MFN status by the United States to Vietnam through the BTA, Vietnamese exports to the United States surged. By 2003, after just two years of BTA implementation, the United States had become Vietnam's largest export destination, accounting for close to 20 percent of total exports. As the bilateral trade relationship has matured, exports to the United States are growing more or less in line with Vietnam's other trading partners. Vietnam currently exports roughly 15–20 percent of its products to each of four major markets: the United States, EU, Japan, and ASEAN.

Whether the importance of the U.S. market will expand in relative terms to these other markets over the next several years will depend importantly on the impact of the elimination of textile and apparel quotas by the United States at the beginning of 2007 (all other countries had already eliminated their textile quotas for Vietnam at the beginning of 2005). If Vietnam's apparel exports grow as rapidly as those of similar apparel-exporting countries following the elimination of the WTO's Agreement on Textiles and Apparel, then the U.S. overall export share could jump up even further (see Table 2). On the other hand, as Vietnam increasingly integrates into regional production networks, intraregional trade should grow more rapidly.

Most importantly, with the opening of the U.S. market for Vietnamese exports resulting from the BTA, Vietnam has developed a much healthier diversification of export markets. Exporting substantial quantities to a number of different destinations will avoid risks involved with being over-reliant on any one market, and will allow Vietnam to adapt more easily to country-specific changes in conditions, such as an economic downturn, or the application of antidumping and other trade remedy actions.

The Impact of the BTA on the Pattern of Vietnam's Imports. Although, as noted above, Vietnamese imports from the United States have also grown solidly after the BTA, the United States remains a relatively minor source of imports into Vietnam, representing between 2 to 4 percent of total imports over the last several years (see Table 7). This is partly a result of the low base of

Customs reports exports "FOB," which is the value at the Vietnamese port. The USITC, on the other hand, reports Vietnam's imports into the U.S. on a "CIF" basis, which includes the costs, insurance and freight charges required to ship the product from Vietnam to the United States. Vietnam's Ministry of Trade suggests that it may also be possible that some value added beyond typical transshipment expenses could be added to Vietnamese exports in third countries, but that such value added was not large enough to represent substantial transformation and thus remained as a Vietnam export. Lastly, there can be timing issues. For example, a Vietnamese export leaving Vietnam in January, and thus recorded in the Vietnamese data as an export in January, may not pass through U.S. customs for a month or two. In this case, that same export would not be recorded as an import from Vietnam into the U.S. until February or March.

imports from the United States to Vietnam before the BTA, and the relatively limited increase in market access to the Vietnamese market by the BTA. Most fundamentally, however, this reflects structural factors that are likely to remain in play well into the future. At Vietnam's stage of development, most of its imports will consist of raw materials and machinery, used for labor-intensive production and infrastructure projects, and imports of lower-quality—and often relatively inexpensive—consumer goods. These types of imports are much more likely to be supplied by Vietnam's Asian neighbors, as reflected in the dominance of China, ASEAN, Korea, Japan, and Taiwan as lead suppliers of imports to Vietnam. As Vietnam becomes increasingly integrated into regional Asian production networks, as well, intraregional trade should become all the more important. This trend toward the dominance of intraregional trade has become evident in most East Asian countries over the last two decades (see Parker 2001).

With Vietnam's reductions in tariffs required for WTO accession, imports should grow more rapidly, including those from the United States. Given the quite low starting point for U.S. imports, however, it is not likely that the United States will become a major supplier of imports to Vietnam for the foreseeable future, even if imports from the United States grow more quickly than the existing major importers to Vietnam.

Table 7: The Geographic Composition Vietnam's Exports and Imports

	2000	2001	2002	2003	2004	2005
Value of Vietnam's exports to (U.S.\$ millions):						
World	14,483	15,029	16,674	20,176	26,485	32,442
U.S.	733	1,065	2,453	3,939	4,992	5,931
E.U	2,845	3,003	3,163	3,853	4,968	5,520
Japan	2,557	2,510	2,437	2,909	3,542	4,411
ASEAN	2,619	2,554	2,435	2,953	4,056	5,450
Rest of world	5,729	5,897	6,186	6,522	8,927	11,130
Growth rate of Vietnam's exports to (%)						
World		3.8	10.9	21.0	31.3	22.5
U.S.		45.3	130.3	60.6	26.7	18.8
E.U		5.6	5.3	21.8	28.9	11.1
Japan		-1.8	-2.9	19.4	21.8	24.5
ASEAN		-2.5	-4.7	21.3	37.4	34.4
Rest of world		2.9	4.9	5.4	36.9	24.7
Value of Vietnam's imports from (U.S.\$ millions):						
World	15,637	16,218	19,755	25,256	31,969	36,978
U.S.	363	411	458	1,143	1,134	864

ASEAN	4,449	3,290	4,769	5,949	7,769	9,459
China	1,401	1,606	2,159	3,139	4,595	5,779
Taiwan	1,880	2,536	2,525	2,916	3,698	4,329
Korea	1,753	2,286	2,280	2,625	3,359	3,601
Japan	2,301	2,183	2,505	2,982	3,553	4,093
EU	1,317	1,506	1,841	2,478	2,682	2,588
Rest of world	2,173	2,400	3,218	4,024	5,179	6,265
Growth rate of Vietnam's imports from (%):						
World		3.7	21.8	27.8	26.6	15.7
U.S.		13.2	11.4	149.6	-0.8	-23.8
ASEAN		-26.1	45.0	24.7	30.6	21.8
China		14.6	34.4	45.4	46.4	25.8
Taiwan		34.9	-0.4	15.5	26.8	17.1
Korea		30.4	-0.3	15.1	28.0	7.2
Japan		-5	15	19	19	15
EU		14	22	35	8	-4
Rest of world		10	34	25	29	21
U.S. share in exports (%)	5.1	7.1	14.7	19.5	18.8	18.3
U.S. share in imports (%)	2.3	2.5	2.3	4.5	3.5	2.3

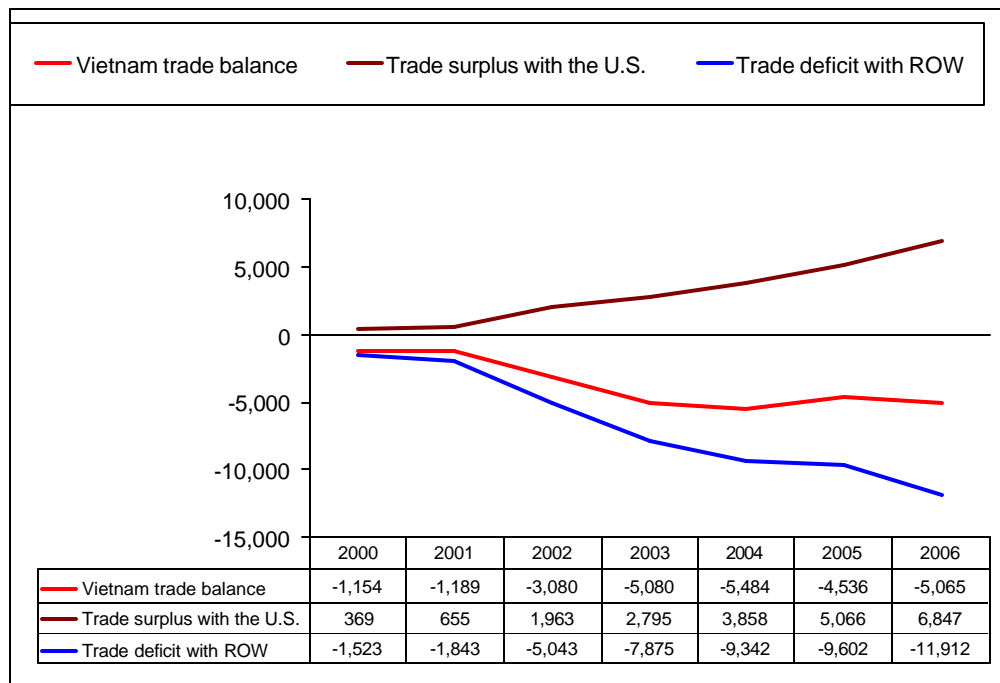
Source: GSO and Ministry of Trade

The Impact of the BTA on Vietnam's Trade Balance. Before the BTA, bilateral trade between Vietnam and the United States was small, as was the bilateral trade balance (see Figure 8). As noted above, given that the BTA provided much stronger incentives for Vietnam to increase exports to the United States than for the United States to increase exports to Vietnam, Vietnam-to-U.S. exports grew much faster than U.S.-to-Vietnam exports. This has given Vietnam a rapidly increasing bilateral trade surplus with the United States. According to USITC data, this surplus has grown from around US\$600 million to around US\$7.5 billion from 2001 to 2006; using Vietnam General Statistical Office data, the surplus has increased from about US\$650 million to about US\$6.8 billion over the same period.

As noted above, however, the cause of this bilateral surplus is largely structural and does not result from Vietnam's economic policy. For example, while almost 50 percent of all Vietnamese exports to the United States consist of apparel, Vietnam actually contributes only a small fraction of the overall value of those exports through domestic value added (typically estimated at roughly 5–10

percent). Most of the value of those exports consists of imported inputs, much of which are supplied by Asian suppliers. This situation means an observer could predict that, given an open trading arrangement, that Vietnam would run a large trade surplus with the United States while running at the same time a large trade deficit with its Asian neighbors. And that is in fact what has happened. As shown in Figure 8, Vietnam has consistently run a substantial overall trade deficit with the world, even though it is running a large trade surplus with the United States. In this regard, Vietnam's trade balance trends are much different than those exhibited recently by its neighbor China.¹

Figure 8: Vietnam's Trade Balance with the U.S. and the Rest of the World



Source: GSO and Department of Customs (USITC data on the surplus with the United States can be different)

1. Although many look at Vietnam as being a mini-China, a perception that might be reinforced by its large trade surplus with the U.S., Vietnam has consistently run a substantial overall trade deficit. There appears to be no indication that Vietnam is running a "mercantilist" policy. In 2006, total Vietnamese exports were US\$39.8 billion and total imports were US\$44.9 billion, leading to a total trade balance deficit of US\$5.1 billion (see Appendix Table 2). This breaks down to a bilateral trade surplus with the U.S. of US\$6.8 billion and a trade deficit with the rest of the world of US\$11.9 billion (Source: using Vietnam GSO data, *Vietnam Economic News*, No. 10, Vol. 7, March 2007). Both Vietnamese exports and imports have been growing quite rapidly over the last four years, with imports growing somewhat faster, leading to a moderately expanding trade deficit.

Nevertheless, rapid increases in exports and the emergence of significant bilateral trade imbalances often give rise to trade disputes. Over the first five years of the BTA, as discussed earlier, the United States has already applied quotas on Vietnam apparel exports and antidumping actions on fish fillets and shrimp.¹ It is, therefore, useful to look at the relative sizes of the two economies to assess the potential for negative economic impact resulting from expanded bilateral trade flows.

The striking fact is that in spite of its relatively large population (83 million, or about 30 percent of the U.S. population), Vietnam's economy is minuscule as compared to that of the United States (see Table 8). Indeed, in 2005, Vietnam's gross domestic product (GDP) was equivalent to only four-tenths of 1 percent of the U.S. GDP. Although U.S. imports from Vietnam have grown rapidly since the BTA came into effect, in 2005 they constituted only four-tenths of 1 percent of total U.S. imports (up from less than one-tenth of 1 percent in 2001). Even if we look at specific products where Vietnam exports to the United States have been exceptionally strong, for example clothing and footwear, we find that the shares of imports from Vietnam are quite small. Indeed, Vietnam-made clothing and footwear account for only 1 percent of U.S. consumption of those products. Finally, Vietnam's "large" surplus with the United States accounts for only 0.7 percent of the U.S. overall trade deficit. The U.S. market is of great importance to Vietnam, but Vietnam's overall impact on the U.S. market is inconsequential.

Table 8: Indicators of the Relative Size of the U.S. and Vietnamese Economies
(percentages)

	2002	2003	2004	2005
Vietnam's GDP/U.S. GDP	0.33	0.36	0.39	0.42
Imports from Vietnam/total U.S. imports	0.21	0.36	0.36	0.40
Clothing imports from Vietnam/total U.S. clothing imports	1.41	3.49	3.56	3.58
Footwear imports from Vietnam/total U.S. footwear imports	1.46	2.10	2.88	4.02
Clothing & footwear imports from Vietnam/U.S. consumption	0.37	0.87	0.93	1.00
U.S. trade deficit with Vietnam/U.S. total trade deficit	0.39	0.60	0.63	0.71

Source: U.S. International Trade Commission electronic database and the Economic Report of the President of the United States, 2006.

1. In response to Vietnam's rapidly growing exports, antidumping cases against Vietnamese exporters have also been lodged by the EU and Canada.

CHAPTER 4

THE BTA AND FOREIGN INVESTMENT INTO VIETNAM

The BTA has a full chapter (Chapter IV) on developing investment, which among other things, aims to increase market access for a number of sectors, to streamline investment licensing and registration procedures, to enhance protections against expropriation and nationalization, and to allow access for international arbitration to resolve disputes. BTA Chapter III on trade in services, as well, provides for greater market access in more than 20 service sectors. In addition, requirements to improve the business environment more generally in Vietnam are spread throughout the BTA, which further improves the attractiveness of the Vietnamese economy for foreign investors. These would include those provisions of the BTA that strengthen intellectual property protection, improve customs procedures and trading rights, provide for greater legal and administrative transparency, improve judicial review of administrative decisions, enhance access to international arbitration, and streamline investment licensing and registration procedures.

The WTO Accession Protocol expands market access for foreign investment even further, both by extending market access commitments agreed to in the BTA for U.S. firms to businesses from all WTO members, and by expanding the number of sectors and, in some cases, the depth of market access liberalization relative to commitments in the BTA. For investment facilitation, the BTA actually has stronger requirements than were included in the WTO Protocol. Since most of these BTA requirements have been applied to other WTO members, however, investment facilitation has effectively been improved for all WTO members, not just for U.S. firms.

The BTA and WTO increased considerably the credibility among foreign investors that Vietnam is committed in the long-term to a policy of market-led growth, protection of investment rights, and improving its business environment for foreign investors. These commitments signal Vietnam's determination to develop a rules-based commercial system in line with international rules and standards. Since these treaties do not allow back-tracking on reforms, the full

implementation of the BTA and WTO greatly increases the predictability of what Vietnam's economic policy is likely to be well into the future. This reduces risk perceptions for foreign investors, a key factor to encourage investment as foreign investors assess the relative attractiveness of one country versus another.

A number of factors have made Vietnam an increasingly attractive and profitable place for foreign investment—extensive BTA and WTO obligations that are bound by treaty, the BTA's opening of the U.S. market to Vietnamese exports, improvements in Vietnam's business environment, and solid prospects for continued strong economic growth. These positive dynamics apply to both foreign direct investment (FDI), say to build production facilities and to provide services, as well as to indirect, portfolio investment in Vietnamese firms through the stock market and private placements in existing or newly established companies. The recent \$1 billion investment by Intel in a chip manufacturing factory in Ho Chi Minh City stands out in this regard to FDI, and the surge in foreign investment funds in this regard to indirect investment flows.

In relative terms, given the limited reductions on tariffs for goods and the much more extensive requirements to develop investment in the BTA, the BTA would be expected to have a greater impact on U.S. investment into Vietnam than on U.S. exports to Vietnam. Most directly, Vietnam committed to gradually allow greater access for U.S. investors in sectors where FDI had previously been restricted, including financial services, trading and distribution, telecommunications, and legal and consulting services, most of which are areas in which the United States is highly competitive.

A core part of our analysis in this chapter focuses on evaluating the following anomaly. Although a previously, as noted above, we would expect the BTA to generate a strong increase in investment from the United States to Vietnam, normal FDI data reported by the MPI showed that U.S. FDI did not increase substantially over the years following the BTA. And yet, anecdotal evidence in the form of many U.S. firms operating in Vietnam would support a conclusion that U.S. firms did respond to the improved business environment resulting from the BTA. In fact, normally-reported data had consistently reported a small investment presence by U.S. firms in Vietnam over the last twenty years—the United States was ranked as the 11th largest investor in Vietnam in 2004, well behind many countries much smaller than the United States and again, out of line with the large number of U.S. firms operating in Vietnam.

To shed light on this issue, FIA and STAR completed a research project that revealed that a substantial amount of FDI from U.S. firms into Vietnam originated from overseas subsidiaries of U.S. firms operating in third countries, particularly in Singapore, Hong Kong, the Netherlands and various tax-haven,

island countries. For example, the Intel investment project will be reported as FDI from Hong Kong, not the United States, since the funds will be provided from Intel's subsidiary in Hong Kong. As will be shown below, "U.S. related" FDI, which includes both the normally-reported FDI sourced directly from the United States and FDI sourced by U.S. firms through third countries, is around three times higher than the normal reported U.S. FDI over the last 20 years, and has expanded rapidly over the last five years following the coming into effect of the BTA in 2001. U.S. firms have, indeed, been strong investors in Vietnam for a long time, and have become even more aggressive since the BTA.

Additional new analysis is provided to show the rapid increase in indirect, portfolio investment into Vietnam since the BTA, especially over the last several years. A compilation of activity by investment funds and related interviews as of mid-2006 revealed that possibly as much as one-half of these new indirect investments are coming from American sources.

Given the strong investment commitments in the BTA and the importance of foreign investment for Vietnamese development, this chapter provides an extensive review of the changes in Vietnamese policy that affect foreign investment. We then evaluate in some detail the response of overall investment flows from 2001 to 2006 compared to trends before the BTA. In particular, we focus on the response of investment flows from U.S. firms into Vietnam. In the next chapter, we present results from a survey of foreign investors on their perceptions of the impact of the BTA on their investment decisions, and more generally, of the impact that Vietnamese reforms over this period have had on investment.

A. A REVIEW OF INVESTMENT REFORMS

The business environment in Vietnam has improved considerably as Vietnam has deepened its reforms. In 2005, for the first time, Vietnam developed a common legal framework for all types of investment with the adoption of the new Investment Law (2005) and Enterprise Law (2005). These two laws, which were developed in parallel to achieve mutually reinforcing objectives, established a roughly level playing field for foreign, private and state investors in line with Vietnam's international commitments in the BTA, WTO and other investment agreements. Though foreign and domestic investors are not treated exactly the same in these laws, a number of restrictions on foreign investment have been removed, procedures and protection for foreign investment have been improved, and with the conclusion of the WTO, a number of sectors will be further opened for foreign investment, as follows:

- The concept of investment has been broadened to cover all types of investment, in line with requirements in the BTA;
- Foreign investors can have 100 percent ownership of their firms in all unrestricted sectors;
- Foreign investors are allowed to set up joint-stock companies and issue securities;
- Foreign investors are allowed to use international arbitration or foreign courts, and foreign laws can be used where Vietnamese law does not cover the issues in dispute;¹
- Licensing by registration is allowed for foreign direct investment under VND 300 billion (US\$18.75 million) in unrestricted sectors;
- Export performance and trade-related investment measures are eliminated (TRIMs);
- Dual pricing and other discriminatory practices are eliminated;
- Restrictions on capital contribution and requirements for using Vietnamese for senior management in joint ventures have been removed;
- Other corporate governance regulations have been improved;
- Protections against expropriation and nationalization have been strengthened;
- Repatriation of investment profits is allowed; and,
- In line with treaty requirements, market access restrictions have been liberalized substantially, especially for most services sectors.²

In addition to the adoption of the new Investment Law and Enterprise Law

1 The BTA requires that Vietnam join the International Center for Settling Investment Disputes (ICSID), an World Bank supported facility that provide binding arbitration for foreign investor disputes with government policy makers. To date, Vietnam has not yet acceded to ICSID.

2. Several major BTA commitments to liberalize service sectors were delayed until the completion of the WTO accession negotiations, in particular for telecommunications and for distribution and marketing. On the other hand, these two new laws that thoroughly revised previous investment policy and company law introduced several policies that may restrain domestic and foreign investment. These include a new requirement that domestic private investors must have larger projects evaluated and approved and that many key decisions by the Board of Directors of a firm would have to be approved by up to two-thirds of all share holders (the super-majority requirement). The super-majority requirement was eliminated as part of the legislative package to ratify the WTO Accession Protocol.

over the last five years, Vietnam has basically rewritten most of its laws governing commercial activities and judicial procedures in an effort to modernize and improve its business environment, many of which are required in the BTA and WTO, and all of which are required to provide a domestic, market-oriented legal framework to allow these treaties to have the maximum economic benefit for Vietnam. Key additional reforms that improve the business climate for foreign investors include the following:

- A new Law on IPR to strengthen protection for right holders of trademarks, copyrights and patents;
- New rules on court procedures to strengthen the courts;
- New procedural rules to facilitate complaints by business regarding administrative actions by government at the national and local levels;
- Much greater transparency in the law making as a result of the new Law on Laws;
- Improved customs procedures and trading rights;
- New rules on banking and liberalization of foreign banks in Vietnam;
- New rules on legal services and consulting services;
- New Commercial Law and new Civil Code that create a consistent, complementary set of contracting rules;
- The reduction and rationalization of taxes;
- A new Law on Bankruptcy to facilitate exit and relocations; and
- A new Law on Competition to encourage healthy competition and prohibit anticompetitive practices.

The key challenge for Vietnam over the next several years will be transforming these impressive reforms in the “letter of the law” to be effectively implemented and enforced in practice. Foreign investors will be looking closely to assess how effectively these reforms improve day-to-day operations on the ground.

After registering steady improvement, the latest measures of Vietnam’s international competitiveness ranking have recently worsened. In the World Economic Forum’s Competitiveness Index for 2006, Vietnam dropped from 74th in 2005 to 77th in 2006 out of 125 countries; in the World Bank’s Doing Business Report, Vietnam fell from 98th in 2005 to 104th in 2006 out of 175 countries. Even with the many reforms noted in our report implemented over the last five years, Vietnam remains as one of the less competitive in the world. This may in part be

due to a lag in effectively implementing these many reforms. As well, it may also reflect the challenge that Vietnam is not the only country in the world reforming its economy. In many cases, Vietnam has to “run” just to keep up with its competitors. Although these international surveys are far from perfect, they reflect the challenge that Vietnam faces to continue to advance the competitiveness of its own economy and to compete in a rapidly evolving international market where many competitors are also constantly improving their capabilities. This creates new trading and investment opportunities, but also forces Vietnam to “look over its shoulder” at its competitors as it determines the appropriate pace and degree of its own economic reforms.

Attacking corruption. Although not formally required in the BTA, a key constraint for investment is corruption. In international corruption assessments, Vietnam ranks as one of the countries with the worse corruption in the world (a recent international comparison reported by Transparency International rated Vietnam at 2.6 out of 10, with 10 reflecting the best possible score). Nevertheless, Vietnam has made major headway toward building the foundation to limit the debilitating effects of corruption. In 2005, it passed a major Anti-Corruption Law, which required that high ranking government officials report their assets, and the assets of close family relations. A number of high profile corruption cases have been prosecuted over the last several years, affecting high ranking government and Party officials and applying strong penalties. Greater transparency and public education has raised the awareness of the rights of businesses and citizens. Possible major legislative measures are being developed to improve government administrative procedures and to establish an administrative court to adjudicate more effectively complaints against administrative rulings. Although far from being eradicated, progress is being made to curtail rampant corruption. Success in this area should substantially further improve the interest of foreign investors in Vietnam, especially for American firms that face strict U.S. regulations with strong penalties against being involved in foreign corrupt practices.

B. THE EXPECTED IMPACT OF THE BTA ON FOREIGN INVESTMENT

Vietnam’s development strategy encourages foreign investment, especially in export-oriented and high-tech industries. The BTA (and the WTO and other bilateral investment treaties) are important elements of Vietnam’s systematic policy to increase foreign investment. The BTA, specifically, could encourage foreign investment in the following ways.

Opening the U.S. market for Vietnamese exports. The BTA’s immediate reduction of tariff rates on Vietnamese exports from 40 percent to 4 percent

provided incentives for foreign and domestic investors to invest in sectors with strong export potential to the United States. These were most likely to be labor-intensive manufacturing sectors, such as apparel, footwear, toys and so on. In these cases, U.S. firms such as Nike, the Gap, Mattel, and Walmart are often major buyers and distributors of these products, but U.S. firms rarely produce directly these types of products anywhere in the world. As a result, the opening of the U.S. market for Vietnamese exports would be expected to generate FDI from East Asian investors, who have the strongest competitive advantages in these sectors, rather than from the United States.

Opening Vietnamese sectors to FDI. The most direct impact of the BTA on foreign investment was the opening of previously restricted sectors to U.S. investors.¹ The BTA provided a clear schedule for liberalizing access in a number of sectors to U.S. investors, many of which the United States is highly competitive in, including banking, telecommunications, trading and distribution, and legal, consulting, and engineering services. The impact of these reforms, however, will flow gradually as the commitments are phased in over time. In most cases, major market access improvements began at the end of the second year of the BTA (Dec. 10, 2003) and will continue for up to ten years for several important sectors. The scheduling of market access opening in the WTO accession agreement, which includes almost all BTA market access requirements while adding on more, will now supersede the BTA requirements. As a result, FDI responding to market access opening required by the BTA and WTO should increase gradually but solidly over a number of years.

Improving Vietnam's business environment. The BTA obligates Vietnam to phase in a number of reforms to improve the business environment, as represented above. Generally these commitments signify Vietnam's determination to develop a transparent, rules-based commercial law system in line with international rules and standards. The BTA not only has a requirement to implement the WTO's Agreement on Trade-related Investment Measures (TRIMs), it also includes a number of additional, important requirements for improving investment licensing procedures and corporate governance regulations. These commitments, when fully implemented both in law and in practice, will make Vietnam a much better place in which to invest and do business.

Cementing Reforms through Treaties. Vietnam has used international

1. The WTO accession agreement will broaden and deepen most BTA market access commitments, by making the market access reforms deeper, by adding additional sectors for liberalization, and by extending BTA commitment to U.S. firms to business from all WTO members.

agreements, especially the BTA and WTO, as leading instruments to spur systematic domestic economic reform and to increase investor confidence. Treaties introduce “bound” commitments that cannot be rolled back without major repercussions with treaty partners (e.g. the U.S. government with regard to U.S. firms). The BTA, WTO and other international agreements that Vietnam has entered in to have greatly increased the perception among foreign investors that Vietnam will continue its path of economic reform toward a market economy with a robust private sector integrated strongly into world markets.

Promoting indirect investment, not just FDI. Vietnam established a stock market in 2000, and has steadily liberalized access for foreign investors in equity ownership of Vietnamese firms. Foreigners can purchase up to 49 percent of total equity in Vietnamese publicly-traded firms, except for restricted sectors such as banks. Importantly, as well, the improvements in Vietnam’s image as a good place to invest with a likely future of high growth (the next Asian Tiger), establishes Vietnam as a profitable place to invest well into the future. This is critical to attract the interest of investment funds in general, and to meet the fiduciary requirements of major global institutional investors as they look to diversify their investment portfolios among successful economies throughout the world. A minor investment by the huge institutional investors in developed countries can translate to a huge investment in Vietnam’s fledgling stock market.

In the following three sections, we review first overall FDI trends and how they have responded to the expected BTA impacts above, followed by a detailed assessment of U.S. FDI, and then by a preliminary evaluation of rapidly increasing indirect investment flows and the development of investment funds in Vietnam. These sections build upon and update the path-breaking FIA/STAR Investment Report published in 2005. Note that the data presented in our current report may be different (by relatively small amounts) than the 2005 Report as a result of refinements in the data made by FIA.

C. OVERALL FDI IN VIETNAM

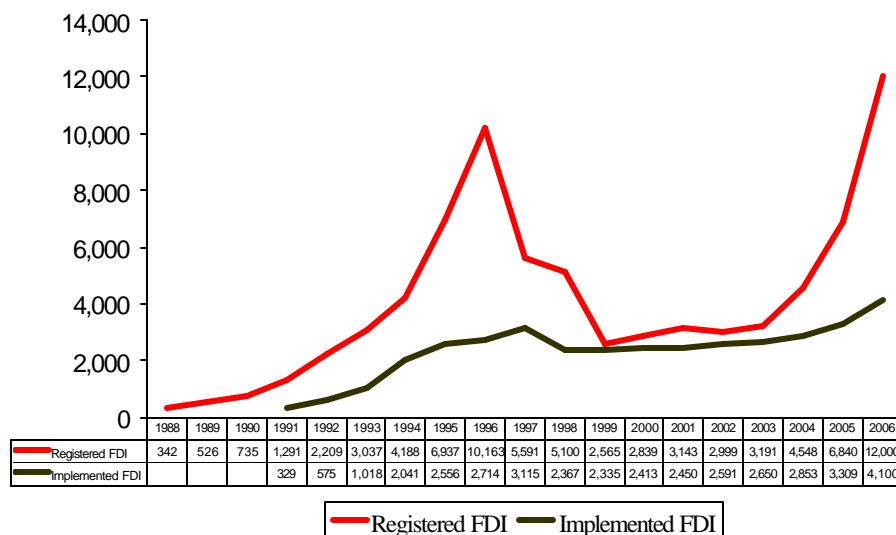
Overall FDI into Vietnam has grown solidly since 2000, as the BTA was being implemented. Registered FDI in Vietnam increased steadily from 1988 to 1996, declined sharply during the Asian financial crisis from 1997 to 1999, rose moderately from 2000 to 2003, and boomed from 2004 to 2006 (see Figure 9). Registered FDI soared to around US\$12 billion in 2006, even more than the level achieved in the mid-1990s investment boom.

Implemented FDI shows a similar but more subdued pattern. It increased steadily from 1988 to 1997, decreased slightly in 1998 and 1999 as the Asian

financial crisis caused firms to reverse investment decisions relative to the spike of registered investment in the mid-1990s, and then picked up solidly again from 2000, especially from 2004 to 2006.

The importance of FDI in Vietnam's economy is substantial. As reported in the WTO Working Paper, foreign investment projects as of December 2005 accounted for 18 percent of total invested capital, 31 percent of Vietnam's export revenue and 37 percent of industrial output, contributing nearly 14 per cent of Vietnam's GDP. Foreign investment projects had created some 620,000 jobs directly, and several hundred thousand jobs were indirectly dependent on these projects.

Figure 9: Overall FDI in Vietnam (from 1988 to 2006)
(U.S.\$ millions)



Source: Ministry of Planning and Investment

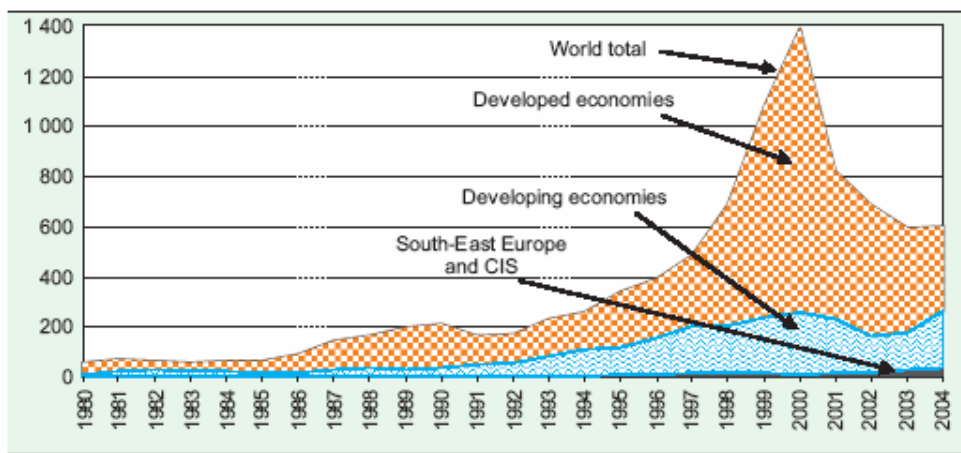
Implemented FDI grew more slowly than registered FDI from 2000 to 2006. The likely cause is the normal lag between the time a firm registers its investment and the time the investment is actually implemented on the ground. We would therefore expect implemented FDI to increase rapidly several years after increases in registered FDI. This is, in fact, what we are seeing. The surge in registered FDI during the early 2000s has been reflected in a significant upswing in implemented investment in 2005 and 2006, which should rise even more in 2007 and beyond. For example, the almost \$1 billion registered FDI by Intel in 2006 will be implemented over the course of several years, and thus will

become apparent in implemented FDI flows from 2007 onward. Moreover, reports from FIA show that foreign firms often want to “test the water” with smaller initial implementation of their investments in Vietnam (smaller than initially registered), scaling up their investments over time as early success is achieved.

Both of these factors emphasize the importance of improving investor confidence steadily over time. When a high percentage of registered FDI is actually implemented, it is a real, bottom-line sign that investors feel confident. Given that foreign confidence in Vietnam, expressed by widespread interest in investing in the country, is based on solid reforms bound by treaty obligations, we do not expect a repetition of Vietnam’s experience of the mid-1990s, when a significant amount of registered FDI failed to translate into implemented FDI. Rather, we believe that the recent boom in registered FDI will result in a similar but lagged boom in implemented FDI over the next several years.

FDI into Vietnam rose as global FDI plummeted. Vietnam’s solid if unspectacular increase in FDI from 2000 to 2003 as the BTA was being finalized and implemented becomes all the more impressive if compared to the experience of other FDI recipients throughout the world over this period. As shown in Figure 10, global FDI plummeted from 2000 to 2003, particularly to developed countries but also substantially for developing countries. Although this negative trend was reversed—in 2003 for developing countries, and in 2004 globally—Vietnam stands out as one of the few developing countries where FDI inflows have grown consistently through the 2000s.

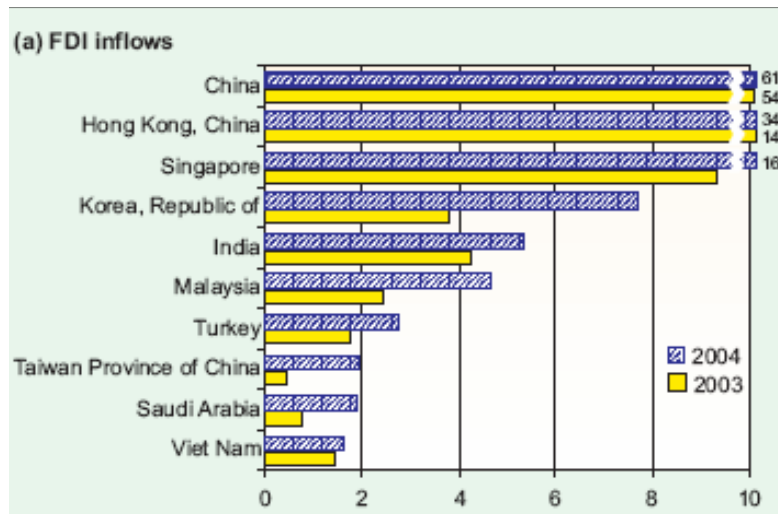
Figure 10: FDI Inflows Global and by Group of Economies (1980–2004)



Source: World Investment Report, UNCTAD, 2005

Although Vietnam is still a relatively minor FDI recipient in the Asia region, it is becoming more and more important. This pattern of higher growth of FDI into Vietnam started in 1999, when the BTA was initially signed by the technical negotiators. In 2004, Vietnam was the 10th largest destination for FDI in Asia (see Figure 11). The recent boom in FDI should shoot Vietnam up this ranking substantially, possibly pushing it past Taiwan, Malaysia, Korea, and India as a major destination for FDI in Asia.

Figure 11: Top ten FDI Recipient Countries in 2004 in Asia and Oceania



Source: World Investment Report, UNCTAD, 2005

FDI projects have begun to grow in size since 2002. Following the Asian crisis, not only total FDI volume but also the average size of FDI projects in Vietnam plummeted, from an average size of around US\$27 million during the peak in 1996 to under US\$5 million in 2002 (see Figure 12). The major reduction in project size reflected the region-wide trend, when economic growth faltered and investors placed a higher risk premium on investments in Asia, including Vietnam. Vietnam also faced the challenge of convincing investors of the seriousness of its reforms, given what many considered a somewhat overcautious attitude that slowed the pace of reform from 1997 to 1999.

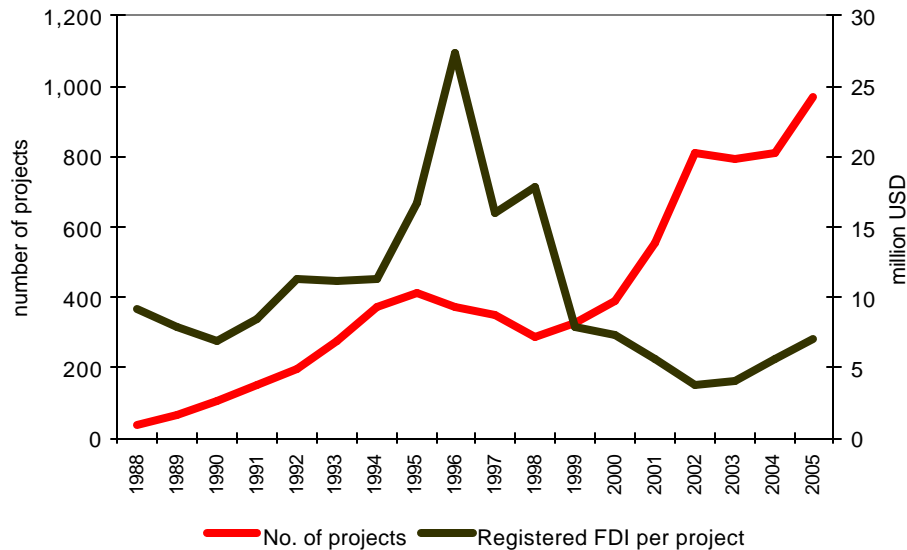
This trend in project size began to reverse in 2003, just a year or so after the BTA came into effect, with the average size of an FDI project increasing solidly in 2004 and 2005. Project sizes nonetheless remain relatively small. This fact

reflects the limited role played by FDI in building infrastructure and more capital-intensive manufacturing in Vietnam, where both sectors are dominated by state-owned enterprises (SOEs).

There is no reason to inherently favor larger over smaller project sizes. In fact, for labor-intensive investments, project capital levels would be expected to be low, which is fully in line with Vietnam's comparative advantage and the creation of large numbers of jobs. On the other hand, Vietnam, as a developing country, needs major capital investments to build and modernize its physical and social infrastructure and to support its move into more capital- and technology-intensive manufacturing sectors. With the recent registration of several huge investments, led by Intel (2006) but including what is expected to be a number of larger infrastructure and manufacturing projects, the average size of an FDI project should increase significantly in the next several years.

A major caveat in this regard, however, is that decisions on investment size must be predominantly market driven. Other countries have used "industrial" policies to create market distortions that artificially encourage investments in large capital-intensive projects—say, for large steel, auto, chemical or oil refining plants—in the hope that they would become competitive over time. In most cases, these policies have burdened the economy with loss-making operations that create far fewer jobs than could have been created with more market-driven investments. An increase in average investment size induced by policy distortions, therefore, would not be desirable. It's important to note that the obligations in the BTA and WTO place major restraints on the use by Vietnam of such distortionary policies.

Figure 12: FDI in Vietnam by Project Size (Number of Projects and Average Size of Investment Projects)



Source: MPI

Overall FDI increased in sectors where exports to the United States grew quickly after the BTA. As noted above, we expected that one of the most direct impacts of the BTA on FDI into Vietnam would be to increase FDI into sectors that were most likely to see a rise in exports in response to the opening of the U.S. market. To evaluate this proposition, we have evaluated FDI inflows into three sectors where Vietnamese exports increased rapidly following implementation of the BTA: clothing and textiles—clothing, footwear, and wood processing and furniture sectors.

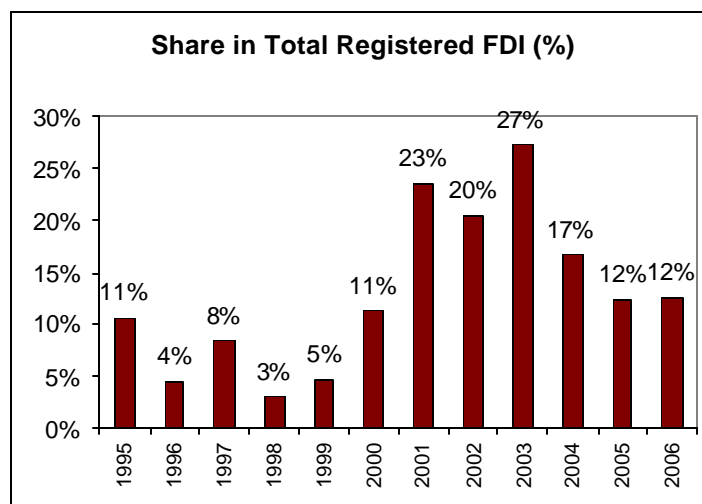
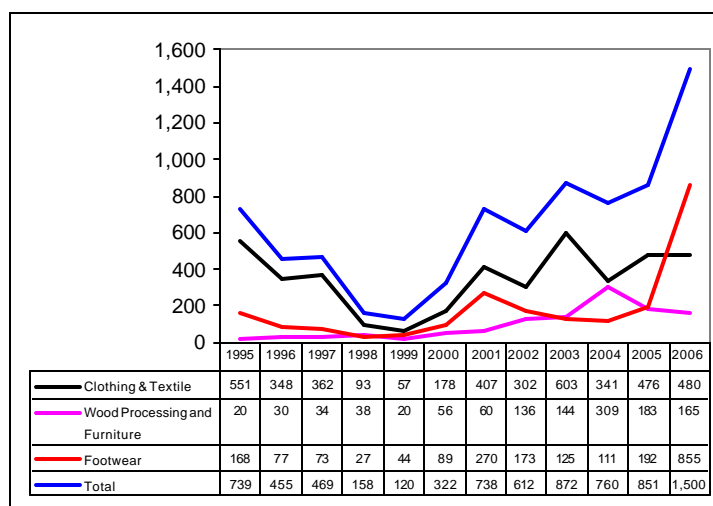
As shown in Figure 13, the opening of the U.S. market to Vietnamese exporters clearly appears to have induced higher FDI into these sectors immediately after the BTA was first signed at the technical level by both countries in 1999. From 1999 to 2005, registered FDI into these three sectors rose nearly sevenfold, increasing from US\$120 million in 1999 to US\$851 million in 2005, and then almost doubled again to US\$1.5 billion in 2006. The share of the three sectors in total registered capital increased from a mere 3 percent in 1998 to a peak of 27 percent in 2003. This share fell back to around 12 percent in 2006 as FDI in other sectors began to grow more rapidly—that is, as the more general effects of the BTA and other reforms began to percolate through the economy.

Observations by FIA experts confirm this conclusion. Most of the investment projects in these three sectors were aimed at exporting to the United States and were made by investors from East Asia—mostly Taiwan, Hong Kong,

Korea, and Singapore. U.S. investors accounted for less than 2 percent of the total registered FDI in these sectors. Thus, as predicted, the BTA appears to have clearly and directly stimulated a substantial increase in FDI from non-U.S. sources to expand production to supply the newly opened U.S. market.

The timing of this increase in FDI was crucial. Given the legacy of the Asian crisis, the BTA-related increase in FDI beginning in 1999 gave a critical boost to overall FDI coming into Vietnam, accounting for essentially the entire increase in overall FDI into Vietnam from 1999 to 2003. From 2000 to 2005, FDI in these three sectors contributed 16 percent of total registered FDI, compared to just 5 percent in 1999. This increase in FDI helped to show the initial benefits of completing the BTA and thus helped to build political support for further reforms. Plainly, without the major expansion in FDI in these BTA-related sectors, Vietnam's overall FDI performance would have been considerably weaker over the last seven years.

**Figure 13: Overall Registered FDI in Sectors with Rapid Exports to the U.S.
Following the BTA (US\$ millions)**



Source: MPI

D. U.S. FDI IN VIETNAM

A long-standing conundrum, as noted above, has been the relatively low levels of reported U.S. FDI into Vietnam, even though U.S. firms operate throughout many sectors of the economy. Furthermore, normal reported FDI data showed only a small increase in FDI from the United States following the BTA. As noted, we expected to find the BTA having a considerable impact on U.S. investment into Vietnam. To shed light on these inconsistencies, FIA and STAR initiated a

research project to investigate more carefully how U.S. firms invest into Vietnam (FIA/STAR Investment Report 2005). The results presented below build upon this initial study and update key investment trends.

It is surprisingly difficult to get a reliable statistical picture of FDI. One complication arises from the distinction noted above in the data between registered and implemented FDI. Another distinction is between the “flow” and the “stock” of FDI: in principle, the latter is the cumulative sum of the former, though in practice it is not, since foreign investments may, with time, be scaled up or down or shut down altogether. If one tries to get a measure of FDI from one particular country—in particular, the United States—a further complication arises. Multinational firms can choose whether to source an investment from a home country office (for example, directly from the United States) or from an overseas subsidiary operating in a third country. This is a particularly important consideration for U.S. FDI, because U.S. tax laws discourage the repatriation of overseas earnings that may be reinvested again overseas. Because of time differences and other factors favoring geographically close management oversight for an investment, there may be additional reasons why a U.S. firm would source an investment in Vietnam from an overseas subsidiary.

This is important because normal reported FDI data track flows sourced from one country to another country—for instance, from the United States to Vietnam. If a FDI project is sourced through an overseas subsidiary, then normal FDI metrics will register that flow as being from the third country, not the home country of the multinational. For example, the large Intel investment announced in 2006 will be carried out through Intel’s Hong Kong subsidiary, and thus will be measured as FDI from Hong Kong to Vietnam, not from the United States to Vietnam. FIA has done an extensive review of FDI project documents to determine whether an investment was made through an overseas U.S. subsidiary. This FDI from overseas subsidiaries is added to normal FDI sourced directly from the United States to calculate a new metric for U.S. investment to Vietnam: “U.S.-related” FDI.¹ Due to FIA data constraints, U.S.-related FDI is available only up to June 2006.

1. Due to resource constraints, it was not possible to do similar calculations for FDI from other countries. Based on discussions by FIA with foreign investors, it appears that almost all FDI made by multinational firms in Korea or Japan are sourced directly from the home country. We do not have even anecdotal evidence at this stage regarding how sensitive EU FDI is to this phenomenon. On the other side, we do know that a significant amount of the FDI from Singapore, the Netherlands, Hong Kong, and various tax havens to Vietnam has been done by U.S. overseas affiliates, which would be included as U.S.-related FDI. Given data limitations, we make no attempt, however, to reduce the FDI from these countries to reflect investment by U.S. affiliates domiciled in their country.

U.S.-related registered FDI is much higher than normally reported FDI and responded much more strongly following the BTA. U.S.-related registered FDI is almost twice the amount of U.S.-reported registered FDI from 1988 to June 2006, showing that normally reported FDI numbers significantly under represent the investment of U.S. firms in Vietnam (see Table 9).

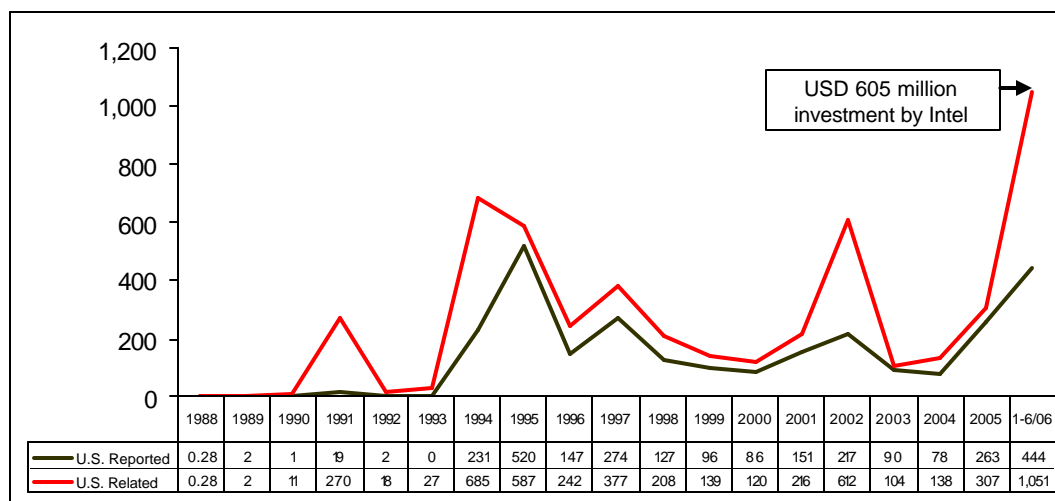
Table 9: U.S.-Related and U.S. Reported Registered FDI, Vietnam (US\$ million)

Year	U.S. -Related				U.S. Reported			
	Number of Projects	Initial Regist'd FDI	Current Regist'd FDI	Share of Total Regist'd FDI	Number of Projects	Initial Regist'd FDI	Current Regist'd FDI	Share of Total Regist'd FDI
1988-98	142	1,807	2,425		97	1,141	1,322	
1999	21	143	139	5.4%	18	100	96	3.7%
2000	21	115	120	4.2%	16	81	86	3.0%
2001	29	160	216	6.9%	28	120	151	4.8%
Average (1999–2001)	24	139	158		21	100	111	
2002	45	426	612	20.4%	40	164	217	7.2%
2003	33	72	104	3.3%	27	58	90	2.8%
2004	35	129	138	3.0%	31	69	78	1.7%
2005	66	307	307	4.5%	61	262	263	3.8%
1-6/06	26	1,051	1,051	42.6%	24	41	444	18.0%
Average (2002–6-2006)	46	441	492		41	222	243	
Total	418	4,209	5,112	7%	344	2,439	2,747	4%

Source: MPI. Data in this figure are not adjusted for dissolved and expired projects. Initial registered FDI is registered FDI at the time of establishment and does not include subsequent capital increases. Current registered FDI is equal to registered FDI at the time of establishment plus capital increases/decreases.

U.S.-related registered FDI also shows a much stronger increase than normally reported FDI around the time the BTA came into force in 2001 and then again in 2005–2006 (see Figure 14). These trends clearly suggest, as hypothesized above, that the BTA has had a significant positive impact on U.S. FDI in Vietnam. The average annual inflow of FDI since the BTA took effect is almost twice as high as it was prior to the BTA. During the first six months of 2006, largely as a result of the Intel investment, U.S.-related FDI accounted for 42 percent of total FDI inflows into Vietnam. Not all of the increase is necessarily attributable to the BTA, since the government has undertaken many other measures in the past five years, but clearly U.S.-related registered FDI has grown strongly since the BTA came into effect.

Figure 14: U.S. Current Registered FDI (US\$ millions)

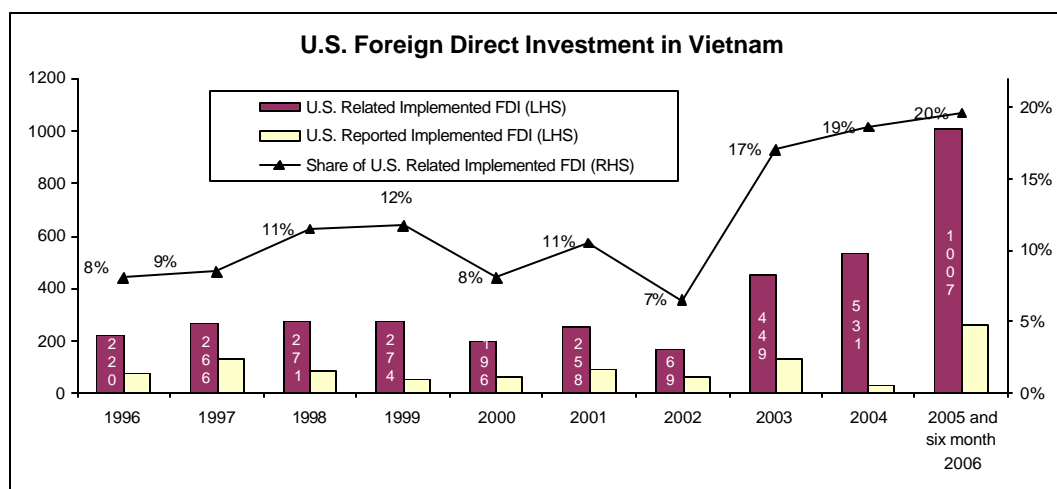


Source: MPI. Data in this figure are not adjusted for dissolved and expired projects. Current registered FDI is equal to registered capital at the time of establishment plus capital increases/decreases.

U.S.-related implemented FDI reflects even stronger results compared to normally reported FDI. Data for U.S.-related implemented FDI show even more strongly that investment by U.S. firms has been significantly higher than normally reported and has responded more robustly than normally reported after the implementation of the BTA (see Table 10 and Figure 15). From 1996 through June 2006, U.S.-related implemented FDI was almost four times greater than normally reported U.S. implemented FDI. For every dollar of U.S. FDI normally recorded as coming into Vietnam, four additional dollars of implemented FDI flowed into Vietnam via U.S. firms located in third countries. There can be no doubt that U.S. firms have invested in Vietnam vigorously throughout the 1990s and 2000s.

U.S.-related implemented FDI has increased particularly rapidly since the implementation of the BTA in 2001. Average annual U.S.-related implemented FDI doubled from 2002 to June 2006 compared to the years 1996 to 2001. By 2005 and 2006, U.S.-related implemented FDI accounted for 20 percent of the total implemented FDI flowing into Vietnam, doubling the share it had prior to the BTA. Higher U.S.-related FDI since the BTA also helped to drive the increase in overall implemented FDI over the last three years.

Figure 15: U.S. Implemented FDI (US\$ millions)



Source: MPI. Data in this figure are not adjusted for dissolved and expired projects. Data for 2005 and the first six months of 2006 are included together because of limitations in updating the U.S.-related FDI for the last six months of 2006.

Table 10: U.S. Implemented FDI Before and After the BTA (US\$ millions)

Year	U.S. Related, implemented FDI	U.S. Reported Implemented FDI	Share of U.S. Related, implemented FDI
1996	220	75	8%
1997	266	133	9%
1998	271	89	11%
1999	274	53	12%
2000	196	62	8%
2001	258	90	11%
Average (1996-2001)	248	84	10%
2002	169	65	7%
2003	449	136	17%
2004	531	27	19%
2005 and six month 2006	1,007	261	20%
Average (2002 - 6-2006)	479	109	16%
Total	3,641	991	

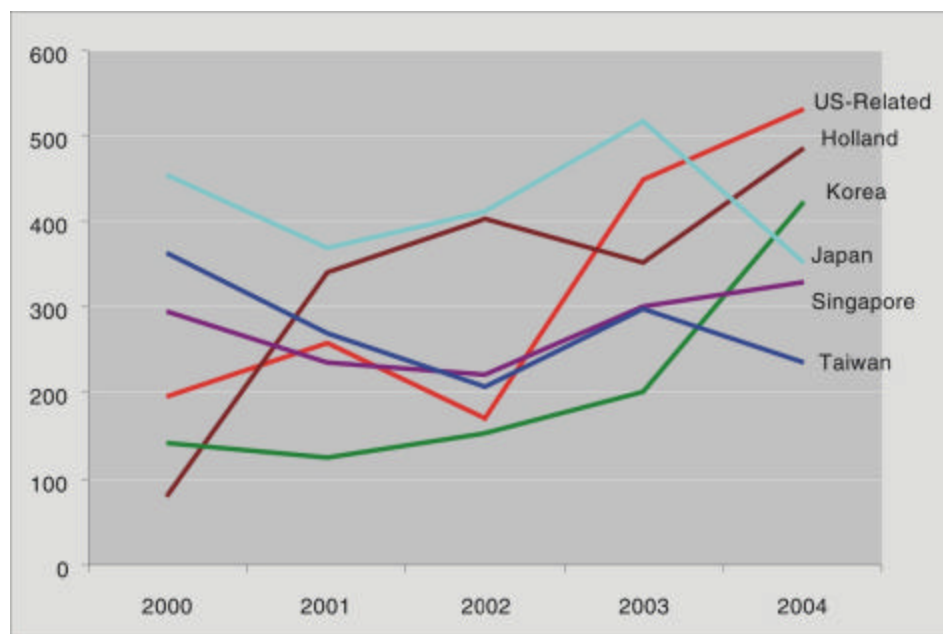
Source: MPI. Data in this figure are not adjusted for dissolved and expired projects.

U.S.-related FDI into Vietnam ranked among the highest of FDI from all countries from 2003 to mid-2006. As shown in our previous Investment Report (2005), U.S.-related FDI represented the largest source of implemented FDI into Vietnam over 2003 and 2004, eclipsing that of the EU, Japan, Singapore, Taiwan, and other sources of FDI typically considered to be most active in Vietnam (see Figure 16 and Table 11).¹ In 2003, U.S.-related FDI surged to the second largest level among all countries, just below Japan. In 2004, U.S.-related FDI exceeded that of all other countries. Although it is not possible to extend this comparison to the period from 2005 to mid-2006, U.S.-related implemented FDI exceeded \$1 billion and U.S.-related registered FDI reached around \$1.4 billion over these 18 months, reflecting a continuing strong increase in U.S.-related FDI into Vietnam. FDI from many other countries increased rapidly over this period as well. It is not important which country's FDI grew fastest; the key point is that both U.S.-related FDI and FDI from a number of other countries grew strongly over 2005 to mid-2006, reflecting the improving legal and policy environment related to the implementation of the BTA, the successful negotiations to accede to the WTO, Vietnam's even broader systematic legal reform, and confidence that Vietnam's economy will continue to grow rapidly.

This result, in fact, qualifies the argument that the initial investment response to the BTA may be dominated by East Asian firms investing in Vietnam to export labor-intensive products to the newly opened U.S. market. Although it appears that East Asian FDI did increase in some key sectors related to exporting to the U.S. market (as noted above for clothing, furniture, and footwear), U.S.-related FDI also increased markedly as the BTA came into force and was implemented—in large part, successfully—over time.

¹ As noted above, it is not possible to re-rank related FDI by country because data are not currently available to calculate "related" FDI for countries other than the United States. It has not been possible to update these results reported in the 2005 Investment Report because data on other country FDI are not available for 2005 and 2006.

Figure 16: Implemented FDI from the Six Biggest Investors in Vietnam
(US\$ millions)



Source: MPI. The U.S. trend line is for U.S.-related implemented FDI. Other countries' trend lines are for reported implemented FDI. Data on relative investment are not available for 2005 and 2006.

Table 11: Implemented FDI in Vietnam by Country, from 2000–2004 (US\$ millions)

Countries	2000	2001	2002	2003	2004
U.S.-Related	196	258	169	449	531
The Netherlands	79	339	403	350	483
Korea	142	125	154	203	421
Japan	454	367	411	515	350
Singapore	294	235	221	300	328
Taiwan	361	269	208	298	235
France	76	137	109	169	152
Hong Kong	195	87	118	76	145
Thailand	35	54	77	67	76
Mauritius	45	85	39	94	62
China	26	27	49	31	51
Russia	216	169	175	74	46
Cayman Islands	18	30	40	39	46
British Virgin Islands	123	108	113	46	45
Australia	24	14	24	30	41
Others	265	311	390	226	206

Source: MPI. Data at country detail are not available for 2005 and 2006.

U.S. FDI by sector. Reflecting U.S. investors' relatively wide-ranging interest in Vietnam, roughly one-half of all U.S.-related FDI from 1988 through 2005 occurred in the mining and petroleum sector, a bit over one-third in manufacturing, with the remainder spread among services, property development, and agricultural sectors (see Table 12). U.S. investment in Vietnam tends to be in the more capital- and knowledge-intensive sectors, as would be expected given its relative competitive strengths compared to Vietnam.

Table 12: U.S.-Related and Total Implemented FDI by Sector in Vietnam Accumulated from 1988–June 2006 (US\$ millions)

	US-Related Implemented FDI	Total Implemented FDI	US Sshare (%)
Mining and petroleum	1,636	6,949	24%
Manufacturing	1,182	15,040	8%
Food and beverages	494	2,243	22%
Chemical and chemical products	175	1,071	16%
Transportation equipment	111	1,424	8%
Non-metallic mineral products	173	2,257	8%
Fabricated metal products	140	572	24%
Other manufacturing sectors	89	7,473	1%
Agriculture and fisheries	56	2,053	3%
Property development	138	2,387	6%
Hotels and tourism	71	2,363	3%
Finance	87	715	12%
Other sectors	111	4,076	3%
TOTAL	3,281	48,623	7%

Source: MPI. Data in this figure are adjusted for dissolved and expired projects.

U.S.-related FDI plays a particularly strong role in the mining and petroleum, food and beverages, and fabricated metals sectors, accounting for about one-quarter of all FDI over the last 18 years in these sectors. It is important as well in the chemicals and finance sector. Overall, however, U.S. firms accounted for around 7 percent of total implemented FDI over this period, and less than 10 percent of total investment in manufacturing sectors. The importance of U.S. investment in a number of service sectors, such as legal services, may be understated by these aggregate product categories.

Sources of FDI from U.S. overseas subsidiaries. U.S. investment from overseas subsidiaries located in third countries comes mainly from countries with liberal tax regimes (such as Mauritius, Bermuda, and the Cayman Islands), those that serve as regional hubs for multinational enterprises (such as Hong Kong and Singapore), and those like the Netherlands with effective tax treaties with Vietnam (see Table 13). Little U.S.-related FDI was sourced from Japan, Taiwan, or Korea.

There are a number of reasons why U.S. firms would choose to invest in Vietnam through their overseas subsidiaries, especially their Asian regional headquarters. First, the BTA covers not only investment sourced in the United States, but also—on an equal basis—investment made by U.S. subsidiaries resident in third countries. Second, and quite importantly, many personnel of U.S. firms operating in Vietnam noted in interviews that U.S. tax laws encourage U.S. firms to source their investments from overseas subsidiaries. Third, there can be managerial and other business operation benefits to having an investment in Vietnam managed by a close-by regional headquarters, especially since most U.S.-related FDI projects in Vietnam tend to be relatively small.

Many prominent U.S. firms operating in Vietnam have sourced their FDI from third countries.¹ For example, American Home, Coca-Cola, Procter and Gamble, Caltex, and American Standards are invested out of Singapore; ExxonMobil, and Intel are sourced from subsidiaries of U.S. operations in Hong Kong; Conoco is invested from the United Kingdom; and Pepsi, British American Tobacco, KPMG, and Cisco are investments by U.S. subsidiaries in the Netherlands. A large oil and gas investment by a U.S. firm originated from Mauritius. As a result, to accurately assess the response of U.S. firms to the impact of the BTA, it is necessary to develop data reporting on FDI from overseas U.S. subsidiaries as well as on FDI sourced directly from the United States.

1. Many other FDI projects by major U.S. firms, of course, have been sourced directly from the United States. For example, major investments by Ford, Citibank, Kimberly Clark, Cargill, Baker & McKenzie, Colgate and Unocal are sourced from the United States. Although considerably more numerous than those sourced from overseas subsidiaries, FDI sourced directly from the U.S. tend to be smaller and are reported by the FIA to have a higher rate of failure than those sourced from third countries.

Table 13: Third Countries from which U.S. Overseas Subsidiaries Invest in Vietnam (1988–June, 2006, US\$ millions)

Resident country for U.S. overseas subsidiaries with FDI to Vietnam	No. of projects	Registered FDI	Implemented FDI
Mauritius	1	65	801
Singapore	19	788	739
the Netherlands	6	229	686
Bermuda	4	107	140
Hong Kong	11	750	126
Cayman Islands	2	58	46
Korea	1	22	32
British Virgin Islands	12	123	25
England	2	31	20
Ukraine	1	16	12
Saint Kitts & Nevis	1	40	12
Taiwan	5	13	8
Thailand	1	0	1
Switzerland	2	60	1
Bahamas	1	8	1
Canada	1	0	0
Cook Islands	2	55	0
Australia	1	1	0
Japan	1	0	0
Total	74	2,365	2,649

Source: MPI. Data in this figure are not adjusted for dissolved and expired projects.

U.S. FDI by location and form of investment. Almost half of U.S.-related implemented FDI is reported as oil and gas, without a provincial designation (see Table 14). Excluding FDI in oil and gas, the majority of U.S. FDI is in five provinces/cities—Ho Chi Minh City, Binh Duong, and Dong Nai in the south, and Hai Duong and Hanoi in the north. For non-oil FDI, these five provinces/cities accounted for 83 percent of U.S.-related, implemented FDI and 71 percent of U.S.-related, registered FDI. Ho Chi Minh City is by far the most popular place for U.S.-related implemented FDI, with around 40 percent of non-oil FDI from the United States.

Overall, U.S. firms invest in southern provinces more than in the north. Of the 11 provinces that have more than US\$10 million of U.S.-related implemented FDI, only four are from the north, and these account for less than 10 percent of total U.S.-related implemented FDI among all provinces.

Table 14: U.S. FDI by Location (Active Projects)
from 1988 through June 30, 2006 (US\$ million)

Provinces	U.S.-Related			U.S. Reported		
	No. of Projects	Registered FDI	Implemented FDI	No. of Projects	Registered FDI	Implemented FDI
Oil and gas*	11	285	1,636	8	161	247
Ho Chi Minh City	131	1,626	670	113	454	78
Binh Duong	45	338	228	40	173	68
Dong Nai	31	380	198	26	265	110
Hai Duong	2	103	148	2	103	148
Hanoi	35	237	123	28	135	55
Ha Tay	5	75	73	4	26	22
Vung Tau	10	415	73	7	333	16
Lam Dong	3	44	53	2	4	1
Hai Phong	9	40	28	5	10	2
Binh Thuan	5	94	15	2	18	0
Bac Lieu	1	10	11	1	10	11
Dac Lac	1	5	5	1	5	5
Da Nang	7	170	4	5	135	2
Phu Yen	5	26	3	5	26	3
Binh Phuoc	2	7	3	2	7	3
Quang Nam	5	61	2	2	26	0
Quang Ninh	2	21	2	2	21	2
Tay Ninh	8	14	2	7	14	2
Can Tho	2	6	1	2	6	1
Quang Tri	2	7	1	2	7	1
Hue	7	22	0	7	22	0
Long An	5	27	0	4	10	0
Vinh Phuc	3	11	0	2	6	0
Nghe An	1	4	0	1	4	0
Vinh Long	2	3	0	2	3	0
Hung Yen	1	3	0	1	3	0
Other	6	5	0	6	5	0
Total	347	4,042	3,281	289	1,994	777

Source: MPI. Data in this figure are adjusted for dissolved and expired projects.

* Oil and gas projects were not identified as being in a particular province.

Most U.S. investment in Vietnam is done through 100-percent-owned enterprises, accounting for around 60 percent of total U.S.-related implemented FDI outside of oil and gas (see Table 15). All U.S. FDI in oil and gas has been done through business cooperation contracts, the only form of investment allowed for oil and gas exploration. Investment through joint ventures (enterprises with less than 100-percent-foreign ownership) accounts for 39 percent of total U.S.-related implemented FDI, while one joint-stock company makes up 3 percent of the total. The number of investments through joint-stock companies should increase in the future with the implementation of the new Investment and Enterprise Laws, which make that form of investment more viable.

Table 15: U.S. FDI by Form of Investment (Active Projects)
from 1988 through June 30, 2006 (US\$ Million)

Form of FDI	U.S.-Related			U.S. Reported		
	No. of projects	Registered FDI	Implemented FDI	No. of projects	Registered FDI	Implemented FDI
100%-Foreign-Owned Enterprises	262	2,863	957	224	1,369	257
Joint Ventures	64	844	644	47	414	229
Business Cooperation Contracts	20	300	1,639	17	176	250
Joint-Stock Companies	1	35	41	1	35	41
Total	347	4,042	3,281	289	1,994	777

Source: MPI. Data in this figure are adjusted for dissolved and expired projects.

E. INDIRECT FOREIGN INVESTMENT IN VIETNAM

In addition to direct investment, foreigners are rapidly expanding indirect investment into Vietnam, largely through investment funds. The first foreign investment fund in Vietnam (Vietnam Investment Fund) was set up in 1991, with total capital of \$54 million. Six more investment funds were established in the following four years, with total capital of \$438 million. The Asian financial crisis halted the growth of these funds—and indeed, all but one of the seven initial funds were either scaled down or terminated (see Table 16).

Table 16: Foreign Investment Funds Established Before 1997

Fund	Size (US\$ Million)	Year of Establishment	Current Status
Vietnam Fund	54	1991	Ended in 2001
Vietnam Investment Fund	90	1992	Scaled down
Beta Vietnam Fund	71	1993	Scaled down
Vietnam Frontier Fund	67	1993	Ended in 2004
Templeton Vietnam Opportunities Fund	117	1994	Ended in 1997 to become Asian fund
Vietnam Lazard Fund	59	1994	Ended in 1997
Vietnam Enterprise Investment Fund	35	1995	Active

Source: Dragon Capital

Since the BTA came into effect in 2001 to mid-2006, however, another 13 investment funds have been established in Vietnam with a combined capital of around US\$1 billion (see Table 17).¹ In addition to the BTA, a number of positive developments have no doubt contributed to this second wave of investment funds in Vietnam, including the new Enterprise Law, the establishment of a stock market in 2000, acceleration of SOE equitization, the relaxation of restrictions on foreign participation in SOEs and in the stock market, the introduction of Vietnam's first securities law in January 2006, and, of course, the continued strong overall performance of the Vietnamese economy.

**Table 17: Foreign Investment Funds Established after 2002
(Fund size estimates as of mid-2006)**

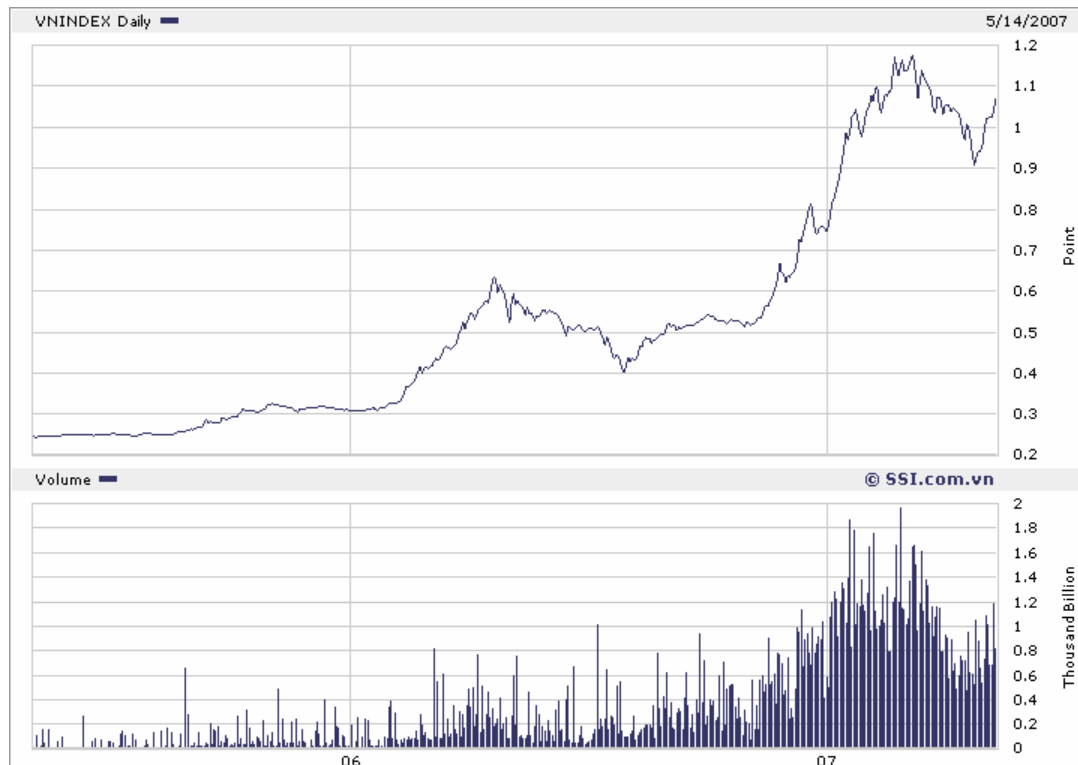
No.	Fund	Size (US\$ Million)	Year of Establishment	Current Status
1	Mekong Enterprise Fund	19	2002	Active
2	Vietnam Opportunity Fund	171	2003	Active
3	IDG Ventures Vietnam	100	2004	Active
4	PXP Vietnam Fund	24	2005	Active
5	Vietnam Growth Fund	100	2004	Active
6	Indochina Land Holding	100	2005	Active
7	Prudential Fund	318	2005	Active
8	Vietnam Equity Fund	18	2005	Active
9	Vietnam Emerging Equity Fund	14	2005	Active
10	Vietnam Dragon Fund	35	2005	Active
11	VinaLand Fund	50	2005	Active
12	BVIM (Vietnam Partners)	100	2006	Active
13	VPF1	13	2006	Active

Source: Dragon Capital and Interviews

1. The number and size of investment funds have continued to grow over the last year. The Brief (2007) reports that 18 investment funds and 50 investment firms had been established by June 2007.

Already these measures are yielding dividends, not only by inducing additional foreign indirect investment, but also in terms of the performance of Vietnam's fledgling stock market. 2006 and 2007 have been banner years in terms of stock prices and the volume of stock trade, as shown in Figure 17.

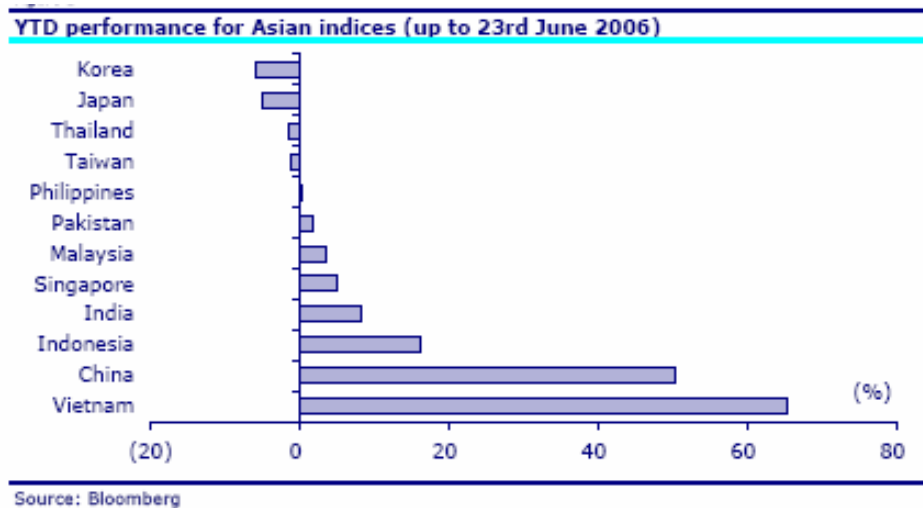
Figure 17: Trends in Vietnam's Stock Exchange (the Vietnam Index of Share Prices and Volumes)



Source: Saigon Securities, Inc.

Net equity asset values have been increasing significantly as prices have increased, as reflected by the 65 percent gain recorded in the Vietnam Index over the first six months of 2006. Vietnam's stock exchange outperformed all other markets in Asia over that period (see Figure 18).

Figure 18: Year-to-Date Performance of Asian Stock Market Indices



The surge in indirect investment and the establishment of investment funds since the implementation of the BTA and other reforms appears to have been driven largely by fundamentals, unlike the more speculative surge in FDI into Vietnam in the mid-1990s. These trends have been reinforced by improved ratings by Moody's and Standard and Poor, and by the successful recent international issuance of Vietnam bonds. BTA and WTO commitments to strengthen commercial systems and investor protections, and to open investment opportunities for foreigners in previously restricted sectors, have been critical to enhancing investor confidence in Vietnam.¹

The important role of U.S. indirect investment. Recently, Merrill Lynch, J.P. Morgan, and Citigroup are reported to have been granted trading codes to buy securities in Vietnam. Smaller U.S. investors have been exposed to Vietnamese securities through their participation in many of the funds listed above. For example, Indochina Capital, a U.S. investment bank specializing in Vietnam, launched a US\$100 million fund in 2005; with U.S. investors accounting for roughly around 45 percent of the funds. Vietnam Partners of the United States, which recently formed a fund management joint venture with Vietnam Bank for Investment and Development, launched a US\$100 million fund, with U.S. investors expected to take up around 30 percent of the fund. Dragon Capital, which manages around US\$600 million in Vietnam, has roughly 30

1. See, *Asian Insight - Buy Vietnam, the Emerging Frontier of Asean*, Merrill Lynch, February 2, 2006.

percent of their funds owned by U.S. investors.¹ The IDG Fund is a wholly U.S.-owned venture capital fund. A very rough estimate is that indirect from Americans may make up one-third to one-half of total indirect investment into Vietnam as of mid-2006. This trend may continue to grow in the future with the formal participation of larger U.S. investment banks and institutional investors.

¹ We emphasize that this estimate is quite rough, as it is based on only interviews with major fund managers in Vietnam as of mid-2006, and that indirect investment into Vietnam is expanding and evolving rapidly.

CHAPTER 5

**PERCEPTIONS OF FOREIGN INVESTORS ON THE IMPACT
OF THE BTA**

In the previous chapter, the impact of the BTA on overall and U.S. FDI was examined based on quantitative or macroeconomic data developed in large part by MPI. To arrive at a more thorough understanding of the impact of the BTA, FIA in cooperation with STAR conducted a firm-level survey on the BTA's impact on the performance of U.S.-invested and non-U.S. foreign-invested enterprises in Vietnam. The survey aims to improve understanding of the impact of the BTA on the performance of foreign-invested companies operating in Vietnam in terms of revenue, investment, and employment, as well as to pose various qualitative questions regarding their response to the BTA. We explore also whether the response to the BTA by U.S.-related firms was different than that of other foreign-invested firms. This survey sample is almost five times larger than a similar survey of foreign-invested firms reported on in the MPI/FIA-STAR Investment Report of 2005.¹ Where possible, we compare results of these two surveys as well.

A. CHARACTERISTICS OF THE SURVEY SAMPLE

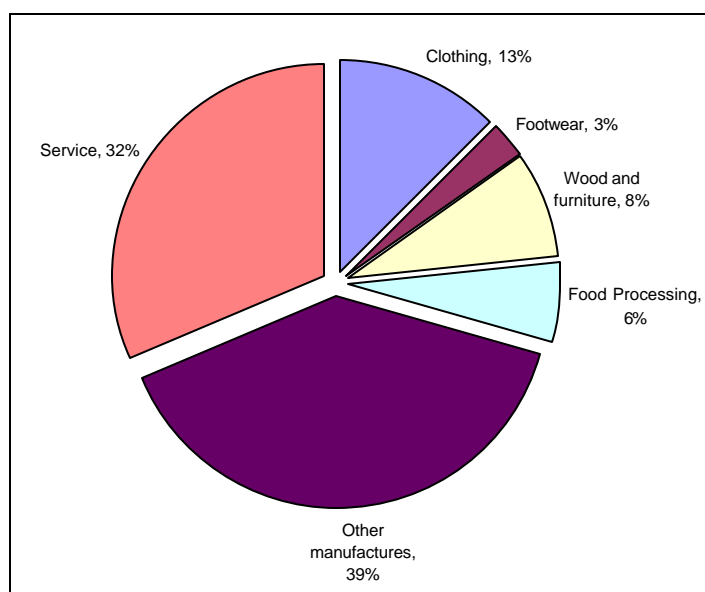
A survey form was mailed in early 2006 to 4,000 foreign-invested enterprises (FIEs) active in Vietnam; 385 responses were returned.² Figures 19 and 20 show

1. See also the USVTC (2004) survey of U.S. companies on BTA implementation issues, which was based on interviews with 80 U.S. companies in the summer of 2003, almost two years after the BTA came into force. The report was published in May 2004, and included some updates on legal reforms. The survey included predominantly companies operating in Vietnam, but also some U.S. companies with an interest in Vietnam who had not yet set up in-country operations. This report provides a good overview of specific BTA obligations, and U.S. business views on the strengths and weaknesses of Vietnam's implementation of specific BTA obligations. The general view after two years was positive, but there remained a number of complaints about how the more BTA-compliant laws and regulations were applied in practice.

2. The number of responding firms by question differs because some firms did not answer every question in the survey. The survey for this report was almost five times the size (385 compared to 81) of a smaller survey of foreign invested firms reported on in the FIA/STAR Investment Report, 2005. This larger survey, however, actually has fewer U.S. firms than did the earlier survey.

the composition of the responding firms by different criteria. The majority of participants in this sample are non-U.S. companies and manufacturing companies—non-U.S. firms made up 94 percent and manufactured firms 68 percent of all firms surveyed. Thus, 6 percent of the firms were U.S.-related and 32 percent were service providers, compared to 5 percent and 25 percent respectively in the overall population of 6,390 foreign-invested projects in Vietnam.¹ The number of U.S. investors in this survey is 24 firms, somewhat lower than in our 2005 survey where 32 U.S. companies responded.² The larger sample enables the research team in particular to analyze more accurately the response of non-U.S. foreign investors to the BTA.

Figure 19: Composition of Responding Firms

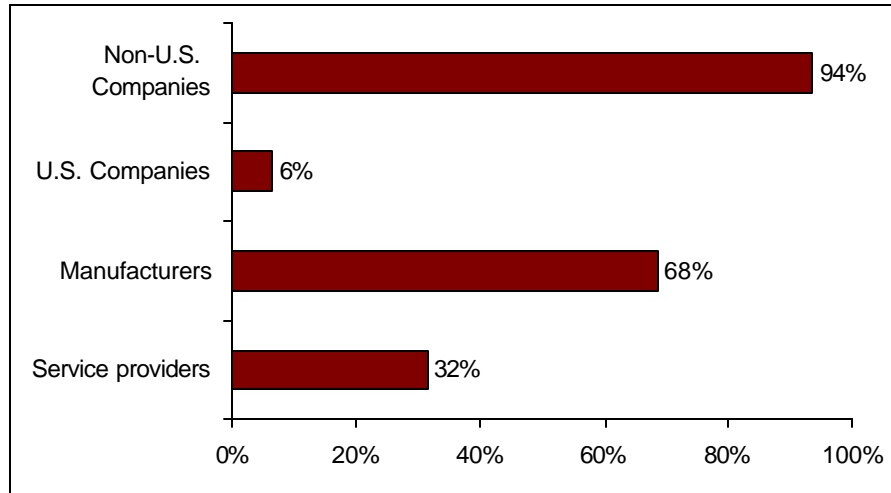


Source: Survey of foreign firms conducted for this Report.

1 U.S. investors include both U.S. and U.S.-related investment.

2 Compared to the 2006 survey, the 2005 survey of foreign investors over-sampled strongly U.S. firms relative to the actual proportion of U.S. firms to overall investors, with 32 U.S. firms out of a total sample of 81 foreign firms.

Figure 20: Characteristics of Responding Firms



Source: Survey of foreign firms conducted for this Report.

B. THE IMPACT OF THE BTA ON FOREIGN INVESTMENT DECISIONS

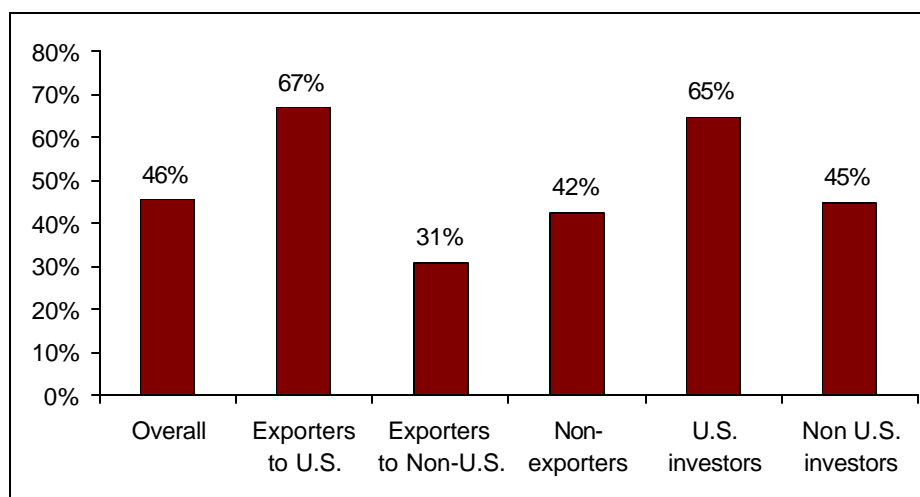
Did foreign investors consider the signing/implementing of the BTA in making/expanding investment? Out of 355 respondents to this question, 162 (46 percent) companies reported that they did consider the BTA in making/expanding their investment in Vietnam (see Figure 21). A substantially larger proportion of U.S. firms (65 percent) compared to non-U.S. firms (45 percent) responded that the BTA was important in this regard. Thus, although the BTA had a greater impact of U.S. firm decisions, it clearly affected importantly almost half of all non-U.S. firms, reflecting a broad-based and systematic impact.

Did foreigners invest in Vietnam to export to the United States market in response to the coming into effect of the BTA? To test this hypothesis, we compare responses to the above question by FIEs that exported to the United States, those that exported but not to the United States, and non-exporters.¹ As shown in Figure 21, 67 percent of FIEs exporting to the United States considered the BTA when investing, while 31 percent of FIEs exporting to non-U.S. markets and 42 percent of FIEs not exporting said they considered the BTA when investing. As would be expected, the BTA had a more important impact on the

1. Exporters to the U.S. are companies with positive exports to the United States. These firms may also export to third countries and/or sell on the domestic market. Exporters to Non-U.S. are companies that export, but not to U.S. market. Non-exporters are companies that do not export.

investment/expansion decisions of foreign investors who exported to the United States, but it did affect investment decisions for more than a third of those FIEs who did not export to the United States.¹

Figure 21: Foreign-Invested Firms That Considered the BTA in Investment Decisions



Source: Survey of foreign firms conducted for this Report.

What did FIEs think were the most important aspects of the BTA that affected their investment decisions? As shown in Figure 22, 57 to 70 percent of the FIE's that answered this question responded that the following four factors related to the BTA most importantly affected their investment decisions: (i) the BTA served as stepping stone for WTO accession; (ii) it created more business opportunities; (iii) it signified Vietnam's commitment to international rules; and (iv) it opened the U.S. market to Vietnam exports.

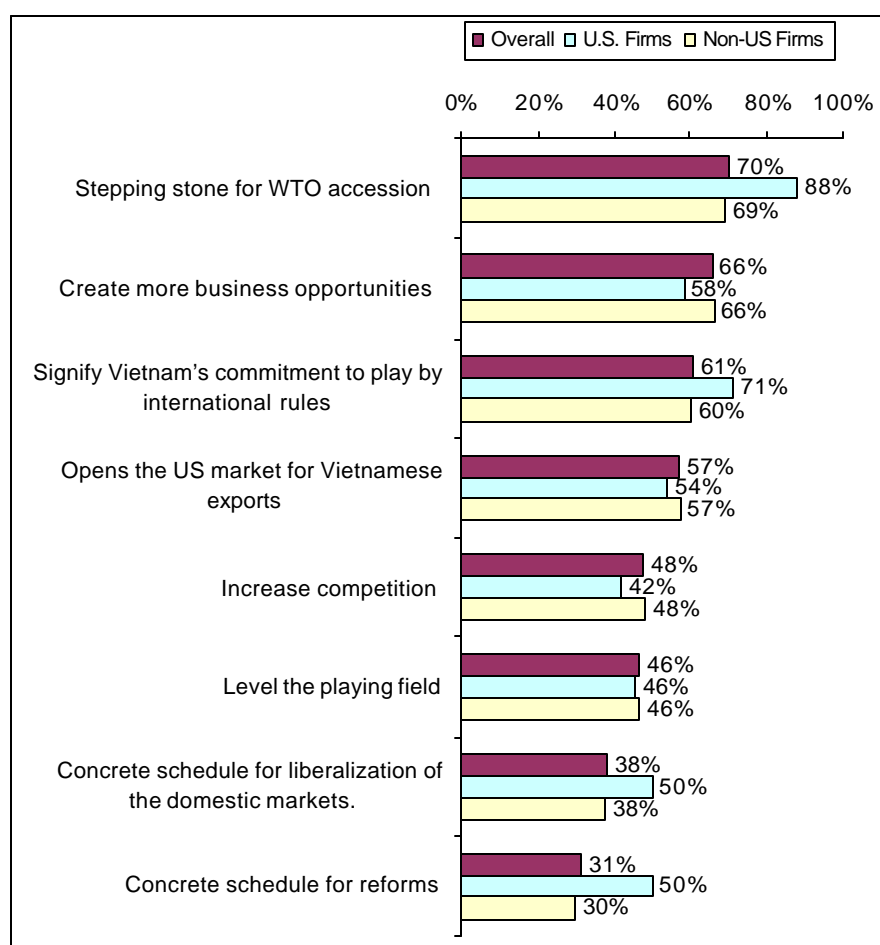
As shown in our previous survey, U.S. relative to non-U.S. FIEs placed substantially greater emphasis on the importance of Vietnam entering into international commitments (with the terms negotiated and results monitored by the USG)—U.S. responses were significantly higher than non-U.S. investors on the BTA serving as a stepping stone to the WTO, on signifying that Vietnam was committed to international rules, and on providing treaty-bound, concrete schedules for administrative reforms and market access liberalization.

A similar analysis was done for FIEs in manufacturing versus services,

1. There were minor differences in responses to this question from firms established before or after BTA, and between service and manufacturing companies.

regardless of nationality.¹ Interestingly, service providers considered each of the elements of the BTA in Figure 22 to be considerably more important than did manufactures, reflecting that service providing firms appear to be considerably more sensitive to the systematic reforms included in the BTA than manufactured firms.

Figure 22: The Significance of the BTA to U.S. and Non-U.S. Foreign Investors



Source: Survey of foreign firms conducted for this Report.

What commitments in the BTA are most important in attracting FDI?

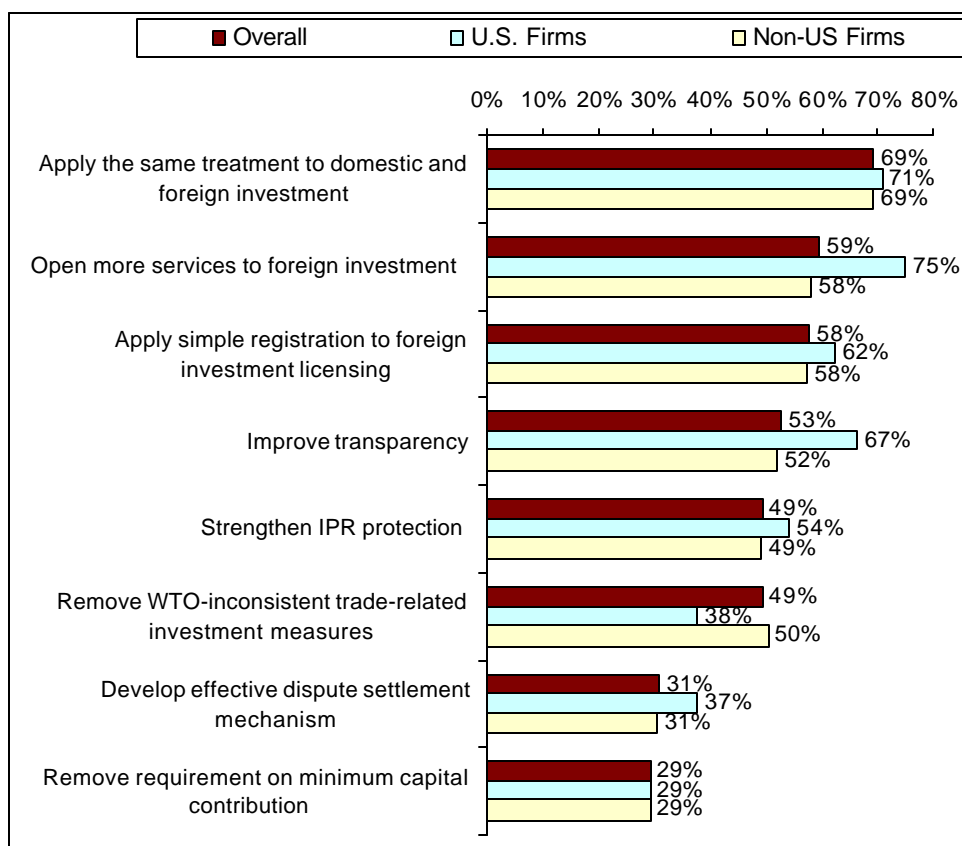
As shown in Figure 23, 49 to 69 percent of all FIEs responding to this question identified the following BTA commitments as most important for attracting FDI: (i) apply equal treatment for foreign and domestic investors (National Treatment); (ii) open more services to foreign investment; (iii) use a simple

1. Differences in responses between manufacturing and service providers are reported in the text. To save space, comparable Figures are not provided.

registration process for establishing a foreign investment; (iv) improved transparency; (v) strengthen IPR protection; and (vi) remove WTO-inconsistent foreign investment requirements. Effective dispute settlement and minimum capital requirements were not generally considered important. U.S. firms place relatively greater emphasis on (i) more open services; (ii) improved transparency; and to a somewhat lesser degree (iii/iv) more effective dispute settlement and stronger IPR protection. On the other hand, non-U.S. investors felt that removing WTO-inconsistent investment restrictions was considerably more important than did U.S. firms.

Assessing manufacturing versus service providers, regardless of nationality, service providers, in line with the results above on the importance of the BTA, emphasized the following BTA commitments much more strongly than did manufacturing firms: (i) open service sectors; (ii) simple FDI registration procedures; (iii) improved transparency; (iv) stronger IPR enforcement; and (v) more effective dispute resolution processes.

Figure 23: BTA Commitments that Help Attract Foreign Investment



Source: Survey of foreign firms conducted for this report.

In summary, results from this survey show that the BTA had an important impact on a majority of FIEs in Vietnam. Although the relative impact was considerably stronger on U.S. firms and service providers, key elements of the BTA, nevertheless, were perceived as being important for many non-U.S. firms and those producing manufacturers in terms of influencing their investment decisions and attracting foreign investors more broadly to Vietnam. U.S. firms and all service providers emphasized many of the BTA commitments most directly related to the legal framework of Vietnam and its international treaty commitments.

C. THE IMPACT OF THE BTA ON FOREIGN-INVESTED ENTERPRISE PERFORMANCE

To evaluate the impact of the BTA on the performance of FIEs, we compare business performance indicators among firms exporting to the United States, firms exporting to non-U.S. destinations, and non-exporters. Although as noted above, the far-reaching impacts of the BTA affected most FIEs regardless of whether they exported to the United States, we would expect the greatest and most direct impact of the BTA to be on those firms that did export to the United States.

Did the number of FIEs grow fastest for those who exported to the United States? From Table 18, the answer to this question is yes—the number of FIEs in the survey exporting to the United States nearly tripled from 2000 to 2005. But, even though growth was significantly more robust for exporters to the United States, the number of FIEs grew strongly in the other two categories as well, almost doubling over this period. This was a strong period of FIE growth in general, particularly from 2003 to 2005, which argues that the BTA, other reforms, and quite possibly progress in WTO negotiations most likely all had a positive impact. As noted in the following section, the stronger growth of exporting FIEs relative to non-exporters reflects the evolution toward a greater export orientation in the economy over this period.

Table 18: Growth in the Number of FIEs in Different Categories

Year	Exporters to U.S.			Exporters to Non-U.S.			Non-exporters		
	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total
2000	3	34	37	2	42	44	2	73	75
2001	3	38	41	2	46	48	3	79	82
2002	6	51	57	2	52	54	3	94	97
2003	6	67	73	3	55	58	2	102	104
2004	6	79	85	4	66	70	2	109	111
2005	9	94	103	4	74	78	3	124	127
Growth (2000-2005)	3.0	2.8	2.8	2.0	1.8	1.8	1.5	1.7	1.7

Source: Survey of foreign firms conducted for this Report.

What was the impact on revenue performance? Revenues generated by sales to export and domestic markets grew strongly for most FIE's from 2000 to 2005, but the rate of growth was much greater for exports to the United States, as would be expected given the substantial stimulus provided by the BTA-related lowering of U.S. tariffs on Vietnamese exports (see Table 19). Before the BTA, only 2.6 percent of FIEs exporting to the United States showed sales to the United States growing at over 50 percent, increasing around four times by 2005. Most strikingly, the proportion of FIEs exporting to the United States with export growth greater than 20 percent increased by almost seven times, from 3.8 percent to 24.6 percent. For the period 2002 to 2006, around the same proportion of U.S.-exporting, non-U.S. exporting, and non-exporter firms (around one-quarter of each type of firm) grew by more than 20 percent. This result conforms with the results reported in Chapter 3 that show exports growing roughly at the same rate to the United States and major non-U.S. markets by 2005/2006. It reflects as well that even though export growth has been a key engine of growth for Vietnam, domestic markets have grown strongly as well (see Figure 24).¹ These trends reflect the maturing of the U.S.-Vietnam bilateral trading relationship and the well diversified structure of Vietnamese exports and domestic sales, all quite positive accomplishments over the five years following the implementation of the BTA.

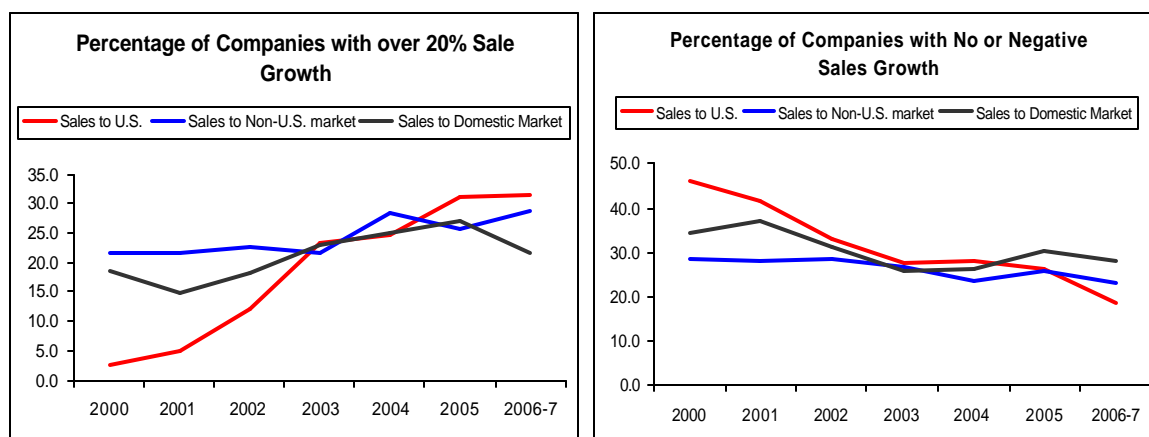
1. Sales to non-U.S. and domestic markets by exporters to the U.S. show a minor increase after the BTA, reflecting little if any crowding out of other markets by growth in this U.S. market.

Table 19: FIE Exporters to U.S., Exporters to Non-U.S. Markets, and Sales to Domestic Markets (percentages)

Year	Over 50% growth	20-50% growth	Over 20% growth	10-20% growth	Under 10% growth	No growth	Decline	No growth & decline
Exporters to the U.S.								
2000	2.7	0.0	2.7	21.6	29.7	46.0	0.0	46.0
2001	2.4	2.4	4.9	19.5	34.2	41.5	0.0	41.5
Pre-BTA	2.6	1.2	3.8	20.6	31.9	43.7	0.0	43.7
2002	8.8	3.5	12.3	19.3	35.1	31.6	1.8	33.3
2003	12.3	11.0	23.3	21.9	27.4	21.9	5.5	27.4
2004	7.1	17.7	24.7	24.7	22.4	16.5	11.8	28.2
2005	16.5	14.6	31.1	21.4	21.4	15.5	10.7	26.2
2006–2007	12.6	19.0	31.6	26.3	23.2	11.6	7.4	19.0
Post-BTA	11.5	13.1	24.6	22.7	25.9	19.4	7.4	26.8
Exporters to Non-U.S. Markets								
2000	13.5	8.1	21.6	23.0	27.0	24.3	4.1	28.4
2001	6.0	15.7	21.7	25.3	25.3	24.1	3.6	27.7
Pre-BTA	9.8	11.9	21.7	24.1	26.2	24.2	3.8	28.0
2002	8.8	13.7	22.6	20.6	28.4	20.6	7.8	28.4
2003	10.8	10.8	21.7	21.7	30.0	16.7	10.0	26.7
2004	9.3	19.3	28.6	20.7	27.1	17.1	6.4	23.6
2005	8.0	17.8	25.8	26.4	22.1	9.2	16.6	25.8
2006–2007	9.1	19.6	28.7	29.4	18.9	14.0	9.1	23.1
Post-BTA	9.2	16.2	25.4	23.7	25.3	15.5	10.0	25.5
Sales to the Domestic Market by All Companies								
2000	9.3	9.3	18.6	26.4	20.7	26.4	7.9	34.3
2001	6.5	8.4	14.8	27.7	20.7	27.7	9.0	36.8
Pre-BTA	7.9	8.8	16.7	27.1	20.7	27.1	8.4	35.5
2002	6.6	11.5	18.0	27.3	23.5	24.0	7.1	31.1
2003	9.6	13.5	23.1	26.4	24.5	20.7	5.3	26.0
2004	10.1	14.9	25.0	26.8	21.9	17.1	9.2	26.3
2005	10.1	17.1	27.1	22.5	20.2	20.2	10.1	30.2
2006–2007	3.8	17.7	21.5	29.7	21.1	21.1	6.7	27.8
Post-BTA	7.0	17.4	24.3	26.1	20.6	20.6	8.4	29.0

Source: Survey of foreign firms conducted for this Report.

Figure 24: High and Low Growth of Exports and Domestic Sales, by Different Categories of FIEs (percentages)



Source: Survey of foreign firms conducted for this Report.

What was the impact on investment? Investment for surveyed firms in all categories grew solidly from 2002 to 2006 compared to before the BTA (see Table 20). Before the BTA, investment in 8.9 percent of all companies grew by 20 percent or more, and 67 percent did not grow at all. After the BTA, around 18 percent of companies on average grew by 20 percent or more, while 54 percent did not grow. These trends would clearly reflect a positive impact by the BTA on the overall foreign investment climate in Vietnam.

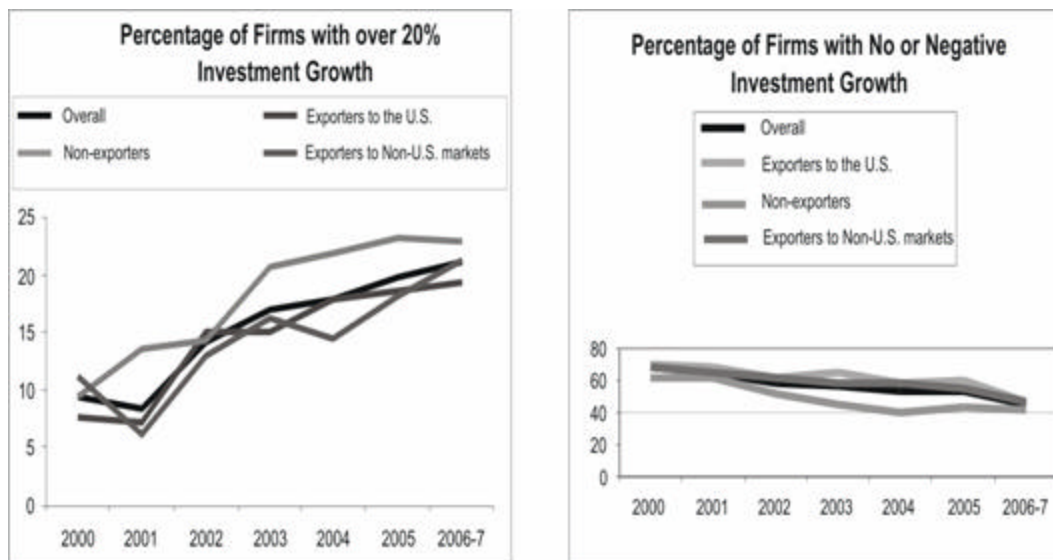
To look more specifically at the direct impact of the BTA on investment, growth of investment in different groups of companies was evaluated. More exporters to the United States saw their investment grow faster and fewer had no growth than exporters to non-U.S. markets and non-exporters from 2002-2006 (see Figure 25). It is not possible to determine whether these differences are statistically significant, but it is indicative that exporters to the United States following the implementation of the BTA increased their investment somewhat more strongly than those who did not export to the United States.

Table 20: Growth in Investment by Different Categories of FIEs (percentages)

Year	Over 50% growth	20-50% growth	Over 20% growth	10-20% growth	Under 10% growth	No growth	Decline	No growth & decline
All Companies								
2000	5.6	3.8	9.4	10.0	12.5	66.9	1.3	68.1
2001	4.4	3.9	8.3	8.9	17.2	63.9	1.7	65.6
Pre-BTA	5.0	3.8	8.9	9.4	14.9	65.4	1.5	66.8
2002	5.6	8.5	14.1	10.3	16.4	57.8	1.4	59.2
2003	8.7	8.3	16.9	9.5	16.5	55.0	2.1	57.0
2004	7.0	10.7	17.8	14.1	14.8	52.2	1.1	53.3
2005	8.3	11.5	19.7	14.7	12.4	51.3	1.9	53.2
2006–2007	7.0	14.1	21.1	19.6	13.7	44.1	1.5	45.6
Post-BTA	7.3	10.6	17.9	13.6	14.8	52.1	1.6	53.7
Exporters to the U.S.								
2000	3.1	6.3	9.4	18.8	9.4	62.5	0.0	62.5
2001	11.4	2.3	13.6	11.4	13.6	61.4	0.0	61.4
Pre-BTA	7.2	4.3	11.5	15.1	11.5	61.9	0.0	61.9
2002	7.1	7.1	14.3	17.9	16.1	51.8	0.0	51.8
2003	12.7	7.9	20.6	14.3	20.6	42.9	1.6	44.5
2004	12.3	9.6	21.9	17.8	20.6	38.4	1.4	39.7
2005	12.8	10.5	23.3	20.9	12.8	39.5	3.5	43.0
2006–2007	10.8	12.2	23.0	21.6	13.5	40.5	1.4	41.9
Post-BTA	11.2	9.5	20.6	18.5	16.7	42.6	1.6	44.2
Exporters to Non-U.S. Markets								
2000	4.8	6.4	11.1	12.7	7.9	68.3	0.0	68.3
2001	1.5	4.6	6.1	10.6	18.2	65.2	0.0	65.2
Pre-BTA	3.1	5.5	8.6	11.7	13.1	66.7	0.0	66.7
2002	5.2	7.8	13.0	7.8	18.2	61.0	0.0	61.0
2003	7.6	8.7	16.3	10.9	14.1	58.7	0.0	58.7
2004	2.1	12.5	14.6	14.6	12.5	58.3	0.0	58.3
2005	7.0	11.3	18.3	14.8	12.2	53.9	0.9	54.8
2006–2007	5.8	15.5	21.4	20.4	11.7	45.6	1.0	46.6
Post-BTA	5.5	11.2	16.7	13.7	13.7	55.5	0.4	55.9
Non-exporters								
2000	7.7	0.0	7.7	3.1	18.5	67.7	3.1	70.8
2001	2.9	4.3	7.2	5.7	18.6	64.3	4.3	68.6
Pre-BTA	5.3	2.1	7.4	4.4	18.5	66.0	3.7	69.7
2002	5.0	10.0	15.0	7.5	15.0	58.8	3.8	62.5
2003	6.9	8.1	15.0	4.6	16.1	59.8	4.6	64.4
2004	7.9	9.9	17.8	10.9	12.9	56.4	2.0	58.4
2005	6.2	12.4	18.6	9.7	12.4	57.5	1.8	59.3
2006–2007	5.4	14.0	19.4	17.2	16.1	45.2	2.2	47.3
Post-BTA	6.3	10.9	17.1	10.0	14.5	55.5	2.9	58.4

Source: Survey of foreign firms conducted for this Report.

Figure 25: High and Low Growth of Investment, by Different Categories of FIEs
(percentages)

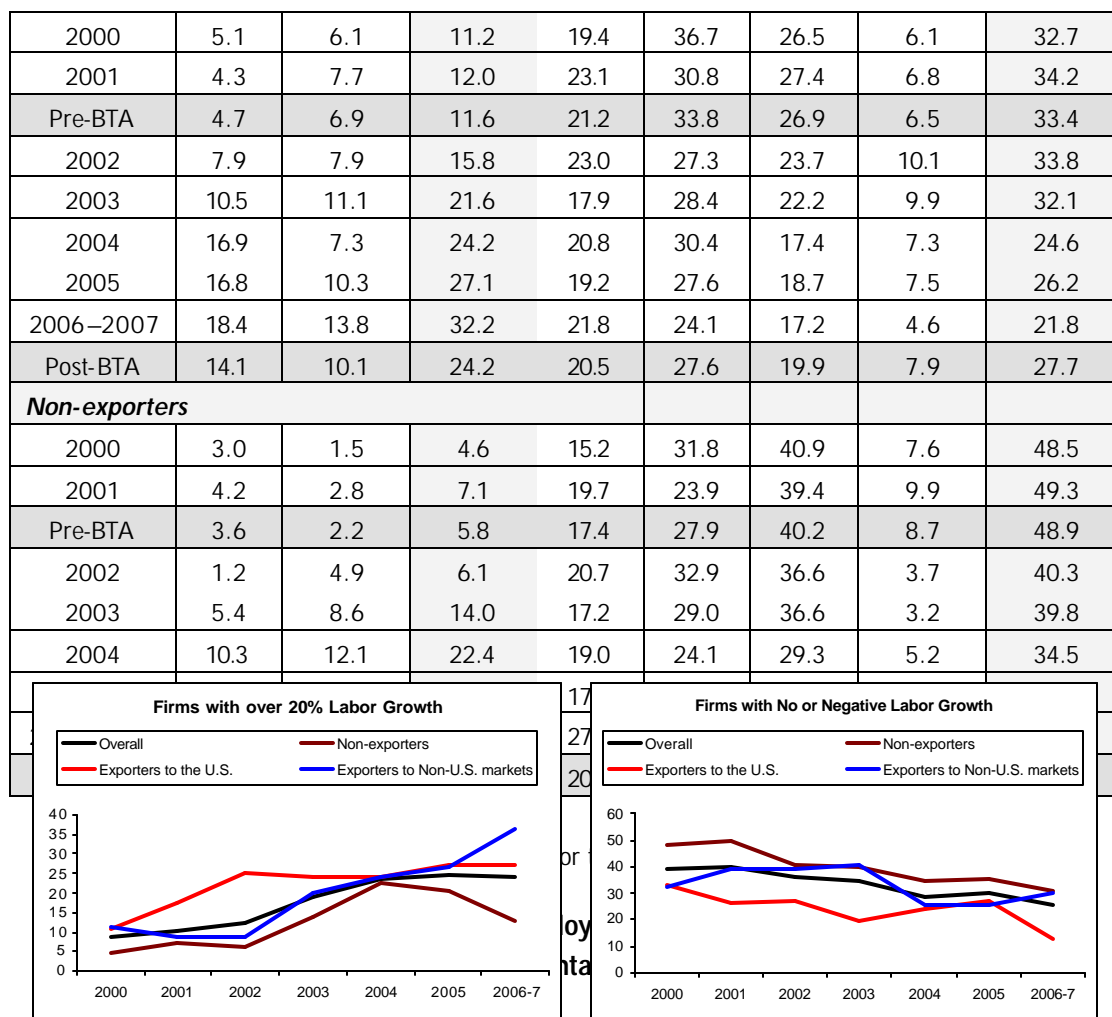


Source: Survey of foreign firms conducted for this report.

What was the impact on employment? For all companies in the survey, the proportion of firms with employment growing 20 percent or more increased robustly from an average of 9.3 percent before 2002 to 20.7 percent from 2002 to 2006, after the BTA (see Table 21 and Figure 26). Similarly, the firms reporting no growth declined from an average of 39.5 percent to 30.0 percent before and after the BTA. Employment for exporters to the United States grew from 14.3 percent to 25.6 percent, while employment for exporters to non-U.S. markets grew on average from 9.9 percent to 23.2 percent, with quite rapid growth in 2005 and 2006. For employment, therefore, both types of exporters increased strongly after the BTA. A more distinctive difference is that all exporters increased employment considerably more strongly than did non-exporters—24.2 percent of exporting firms grew by 20 percent or more while only an average of 13 percent of non-exporters did so. This confirms that export growth in Vietnam since the BTA has tended to be labor-intensive, in line with its comparative advantage, and critically, in line with generating new jobs for Vietnam's rapidly growing labor force.

Table 21: Growth in Employment by Different Categories of FIEs (percentages)

Year	Over 30% growth	20-30% growth	Over 20% growth	10-20% growth	Under 10% growth	No growth	Decline	No growth & decline
All Companies								
2000	4.3	4.3	8.5	17.7	34.8	32.3	6.7	39.0
2001	4.3	5.9	10.1	21.8	28.2	31.9	8.0	39.9
Pre-BTA	4.3	5.1	9.3	19.7	31.5	32.1	7.3	39.5
2002	5.4	6.8	12.2	22.2	29.4	28.5	7.7	36.2
2003	8.6	10.2	18.8	17.7	28.6	27.5	7.5	34.9
2004	14.6	9.0	23.5	20.1	28.2	21.7	6.5	28.2
2005	14.9	9.9	24.8	18.5	27.2	23.0	6.6	29.6
2006-07	14.1	10.1	24.2	24.2	26.2	18.8	6.7	25.5
Post-BTA	11.5	9.2	20.7	20.5	27.9	23.9	7.0	30.9
Exporters to the U.S.								
2000	2.8	8.3	11.1	19.4	36.1	27.8	5.6	33.3
2001	8.7	8.7	17.4	17.4	39.1	23.9	2.2	26.1
Pre-BTA	5.7	8.5	14.3	18.4	37.6	25.8	3.9	29.7
2002	13.3	11.7	25.0	20.0	28.3	21.7	5.0	26.7
2003	14.9	9.0	23.9	22.4	34.3	13.4	6.0	19.4
2004	18.4	5.8	24.1	18.4	33.3	18.4	5.8	24.1
2005	18.7	8.8	27.5	14.3	30.8	19.8	7.7	27.5
2006–2007	15.0	12.5	27.5	30.0	30.0	10.0	2.5	12.5
Post-BTA	16.1	9.5	25.6	21.0	31.4	16.7	5.4	22.0
Exporters to Non-U.S. markets								
2000	6.4	4.8	11.3	19.4	37.1	25.8	6.4	32.2
2001	1.4	7.0	8.4	26.8	25.4	29.6	9.9	39.4
Pre-BTA	3.9	5.9	9.9	23.1	31.2	27.7	8.2	35.8
2002	3.8	5.1	8.8	25.3	26.6	25.3	13.9	39.2
2003	7.4	12.6	20.0	14.7	24.2	28.4	12.6	41.1
2004	15.8	8.3	24.2	22.5	28.3	16.7	8.3	25.0
2005	15.4	11.4	26.8	22.8	25.2	17.9	7.3	25.2
2006–2007	21.3	14.9	36.2	14.9	19.2	23.4	6.4	29.8
Post-BTA	12.7	10.5	23.2	20.0	24.7	22.3	9.7	32.1
All Exporters								

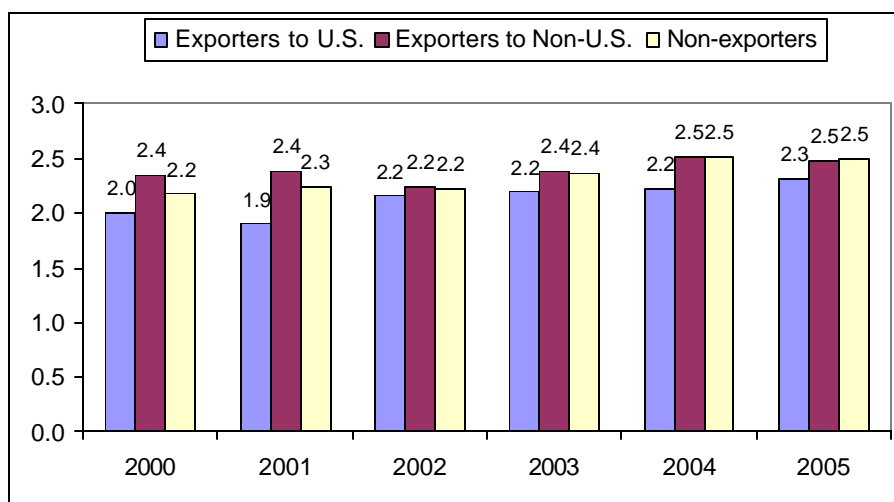


Source: Survey of foreign firms conducted for this Report.

What was the impact on overall business performance? While all FIEs reported that their business performance (a proxy for profitability) improved somewhat after the BTA, FIEs exporting to the United States actually reported weaker business performance than exporters to non-U.S. markets and non-exporters (see Figure 27). This was an unexpected but interesting result, which

could be due to a number of factors. For example, it could be that with the excitement associated with the opening of the U.S. market, expectations of exporters to the United States could have been higher than other FIEs. Another explanation could be that the U.S. market is more competitive than domestic and non-U.S. export markets, which would explain lower profit margins. The relative profitability of exporting to the U.S. market clearly merits further research.

Figure 27: Business Performance by Different Categories of FIEs (4: Excellent, 3: Good, 2: Satisfactory, 1: Bad)



Source: Survey of foreign firms conducted for this Report.

In summary, the five years following BTA implementation (2002–2006) was clearly a high performing period, with foreign-invested enterprises increasing exports, sales to domestic markets, investment and employment quite strongly. This broad, systematically positive result would support the conclusion that the BTA was associated with a major improvement in the operating environment for FIEs in Vietnam. A key result was that FIEs who exported tended to increase employment much more strongly than did non-exporters, reinforcing the result that Vietnamese exports are labor-intensive and in line with its comparative advantage, and that export growth has contributed strongly to creating new jobs in Vietnam since the BTA, achieving a critical socio-economic development objective. In general, FIEs exporting to the U.S. market grew exports, investment and employment even more robustly than FIEs exporting only to non-U.S. markets or for non-exporters. This would suggest an even more directly positive impact of the BTA's opening of the U.S. market for Vietnamese exports. The one anomaly of interest is that FIEs exporting to the United States

reported weaker business performance (profitability) than did the other FIEs, possibly reflecting greater competition in the U.S. market relative to other export or domestic markets.

**D. PERCEPTIONS ON BTA-RELATED AND ADDITIONAL FACTORS
AFFECTING VIETNAM'S BUSINESS ENVIRONMENT
FOR FOREIGN-INVESTED ENTERPRISES**

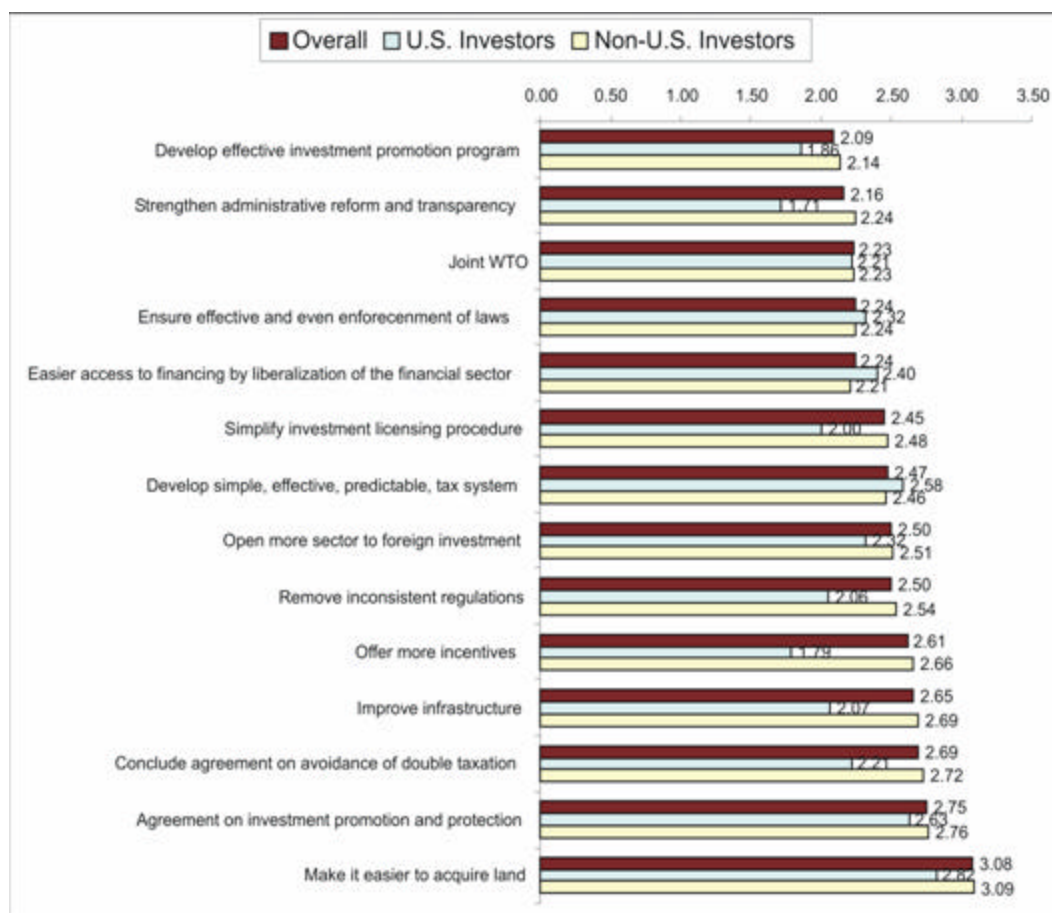
Our assessment of FIE perceptions above has focused on factors related to the BTA. This section reports on a broader set of FIE perceptions on how Vietnam can most effectively improve its business environment for foreign investment in Vietnam. As shown in Figure 28, the surveyed FIEs rated 14 major policies according to how important they were to attract FDI into Vietnam. Each policy was rated by all surveyed FIEs as being relatively important, with an average rating of between 2 and 3, with 1 most important and 5 least important. Most important (rated 2.09 to 2.24) were developing effective investment promotion programs, strengthening administrative reform and transparency, joining the WTO, improving the enforcement of laws, and improving access to credit by liberalizing the financial sector. A next group of issues considered to be only slightly less important (rated around 2.5) included simplifying investment licensing procedures, developing a predictable and effective tax system, opening more sectors to foreign investment, and removing inconsistencies among regulations. A next group again just slightly less important (rated 2.6 to 2.75) included offering more investment incentives, improving infrastructure, concluding a tax treat to avoid double taxation, and stronger protections of investor rights. Still important, but somewhat less so (ranked at 3.08), was making it easier to acquire land.

Interestingly, U.S. firms reported that almost every issue was more important than did non-U.S. firms. U.S. firms rated the following issues as most important (rated 1.71 to 2.32): strengthening administrative reform and transparency, offering investment incentives, developing effective investment promotion programs, simplifying investment licensing procedures, removing inconsistent regulations, improving infrastructure, joining the WTO, concluding a taxation agreement, opening more sectors to foreign investment, and improving the enforcement of laws (which include stronger enforcement of IPR laws). The strongest agreement between U.S. and non-U.S. firms was about the importance of joining the WTO and improving the enforcement of laws. U.S. firms compared to non-U.S. firms placed a substantially greater relative emphasis on the offering investment incentives, improving infrastructure, strengthening administrative reform and transparency,

simplifying investment licensing procedures, removing inconsistent regulations, and concluding a taxation agreement.

These results differ in several important respects from our smaller survey results reported in the MPI/FIA-STAR Investment Report for 2005, especially for U.S. firms.¹ Most importantly, U.S. firms in the new survey place a much greater emphasis on the importance of investment incentives, investment promotion efforts, and improving infrastructure, each of which were downplayed in the earlier sample. Both surveys consistently recognized the importance of improving the implementation and transparency of the legal and administrative system, opening of sectors for investment, and joining the WTO.

Figure 28: Overall Measures to Attract More Foreign Investment to Vietnam
(1 is most important and 5 is least important)



1. Given the relatively small sample of U.S. firms in the new survey, we are reluctant to draw strong conclusions with regard to changing U.S. firm perceptions of Vietnam's foreign investment climate.

Source: Survey of foreign firms conducted for this Report.

CHAPTER 6

THE BTA AND STRUCTURAL CHANGES IN VIETNAM'S ECONOMY

The previous chapters documented changes in Vietnam's trade and foreign investment before and after the implementation of the BTA, with a focus on bilateral trade and investment with the United States. Given the magnitude of these developments, in particular the dramatic expansion of Vietnamese exports to the United States and U.S.-related investment to Vietnam after the BTA came into effect at the end of 2001, it is highly likely that the BTA has had a broader impact on the structure of Vietnam's economy. Based on Vietnam's comparative advantage in global markets, we would anticipate that the BTA would have contributed toward a shift in export-orientation of the economy, a shift in the structure of exports toward labor-intensive manufactured products and, as a consequence, a shift in the structure of industrial production, employment and investment in favor of labor-intensive manufactured goods. Since private firms in many countries tend to excel in exporting labor-intensive manufactures, we might further expect shifts in ownership structure toward foreign and domestic private enterprises after 2002.

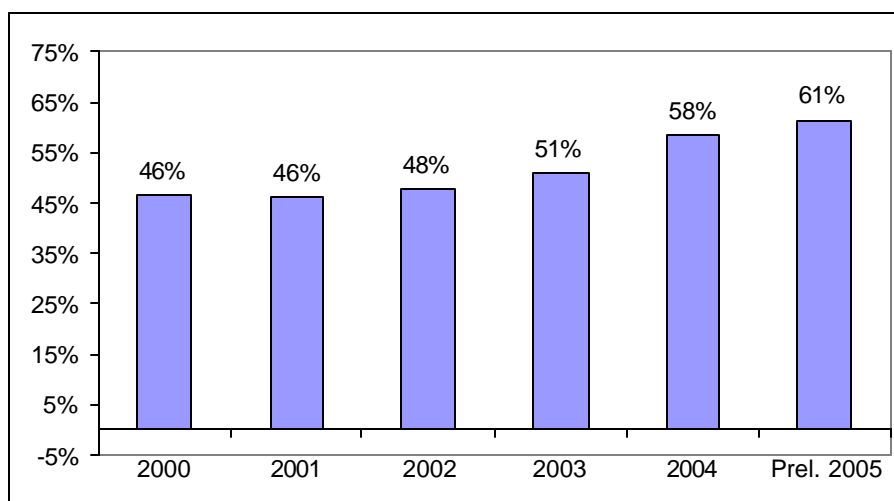
In this chapter, data provided by the General Statistics Office (GSO) are used to assess whether such structural shifts did in fact occur after the BTA came into effect. We recognize, of course, that this kind of analysis cannot provide conclusive evidence that the BTA had the hypothesized effects or, even if it did have, that the structural effects were statistically significant. It is nonetheless instructive, we believe, to examine how Vietnam's industrial structure changed after the BTA came into effect. We also present in an addendum to this chapter a summary of the results of a firm-level study on the impact of the BTA that, using econometric analysis, confirms the relationship between the BTA and the structural changes that are observed in the macroeconomic data.

A. INCREASING EXPORT ORIENTATION AND LABOR-INTENSITY OF MANUFACTURED EXPORTS AFTER THE BTA

Since the end of 2001 when the BTA came into effect, Vietnam has become a considerably more export-oriented economy—the ratio of exports to GDP has

increased steadily, rising from 46 percent in 2001 to 61 percent in 2005 (see Figure 29). No doubt the response on the part of exporters to the opportunities opened up by the BTA is a principal explanation for this development. As we reported in an earlier report, the expansion of exports to the U.S. market did not occur as a result of the diversion of exports from other markets to the United States, but instead constituted an overall increase in exports and the export orientation of the economy (see CIEM/STAR Report, 2003 and 2004, which showed that there appears to have been limited trade diversion associated with the post-BTA surge in Vietnamese exports to the United States).

Figure 29: Exports as a Percentage of GDP

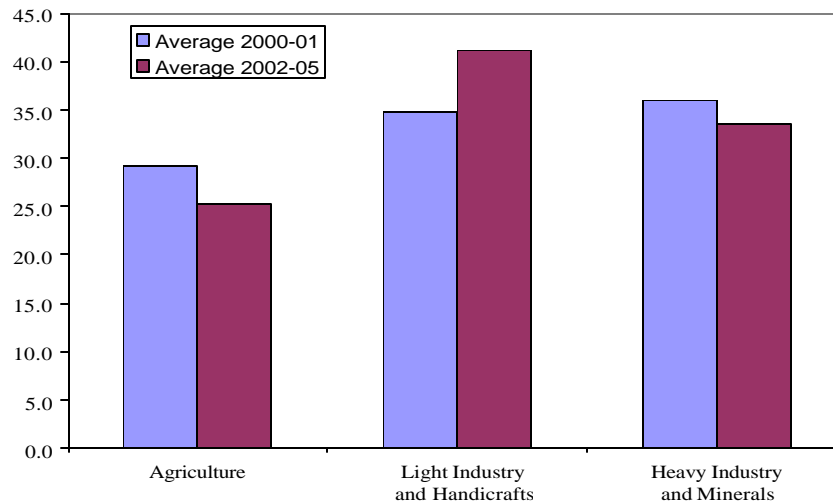


Source: Data on exports and GDP are from GSO and exchange rates from the IMF and State Bank.

The increasing export orientation of Vietnam's economy resulted mainly from the expansion of labor-intensive light industrial and handicraft exports, which as reported in Chapter 3 were the export categories that responded most dramatically to the opening up of the U.S. market under the BTA.¹ As Figure 30 indicates, the share in total exports of light industrial products and handicrafts increased from an average of 38.4 percent for 2000-01 to 41.2 percent for the period 2002-05, while the shares in total exports of agricultural products, and heavy industrial and mineral products, declined after the BTA came into effect.

1. Labor-intensive manufactures (equal to light manufacturing) include the following sectors: apparel, leather/footwear, wood products, rubber products, fabricated metal products, except machinery and equipment, and furniture. All other manufactured sectors are considered non-labor intensive.

Figure 30: Average Export Shares of Agricultural Products, Light Industrial and Handicraft Products, and Heavy Industrial and Mineral Products: 2000-01 and 2002-05
(percentages)

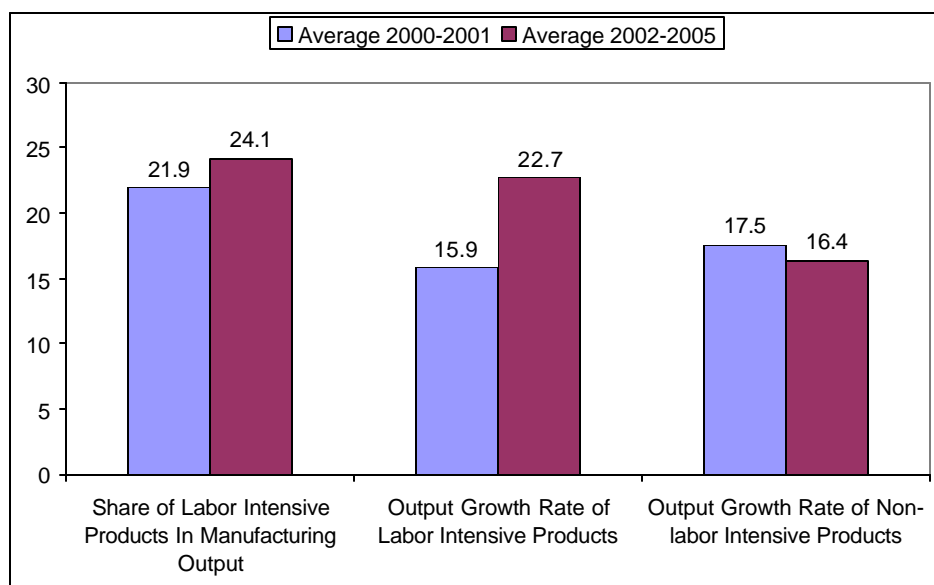


Source: GSO

B. INCREASED CONTRIBUTION OF LABOR-INTENSIVE MANUFACTURED PRODUCTION AND RELATED EMPLOYMENT AFTER THE BTA

The increasing export-orientation of the economy and the increasing concentration of exports in labor-intensive manufactures since 2002 should have had an impact on the structure of industrial production. Figure 31 indicates that such was the case. Although non-labor-intensive goods still dominate in the manufacturing sector, accounting for almost three-fourths of total manufacturing output, the share of labor-intensive products has increased significantly since 2001. The average annual growth of output of labor-intensive goods increased significantly during the BTA period, up from 13 percent prior to the BTA to 23 percent from 2002-05. Moreover, the average annual growth of labor-intensive output significantly outpaced the growth of non-labor-intensive manufacturing output in the later period.

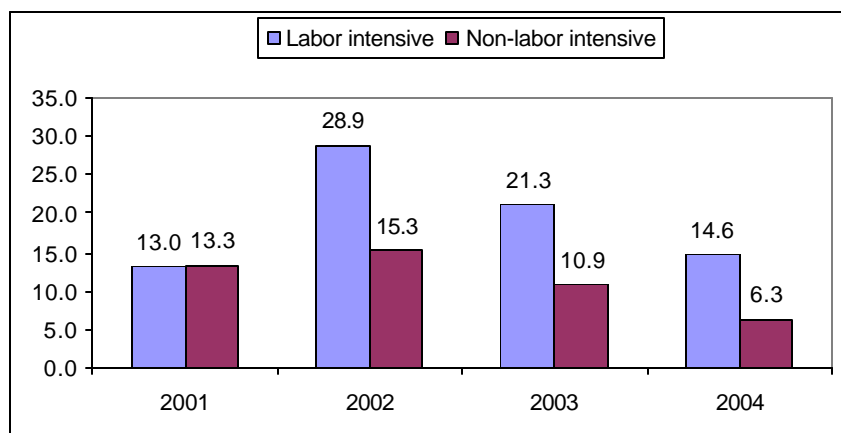
Figure 31: The Share and Rate of Growth of Labor Intensive and Non-labor-Intensive Manufacturing Output (percentages)



Source: GSO

The increasing export orientation of the economy and the consequent acceleration of the growth of labor-intensive manufacturing output after 2001 have indeed had a significant impact on employment, especially in labor-intensive sectors of the economy. As Figure 32 indicates, the growth of manufacturing employment was exceptionally high after 2002, particularly in labor-intensive sectors.

Figure 32: Growth Rates of Manufacturing Employment in Labor Intensive and Non-labor Intensive Sectors: 2001-05 (percentages)



Source: GSO

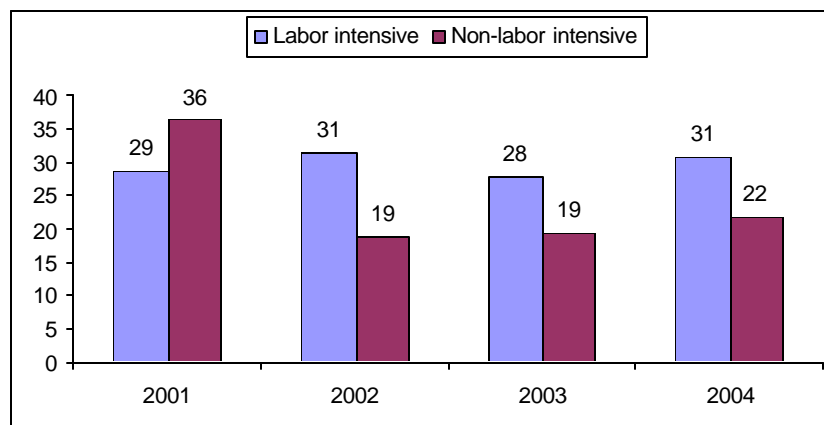
These trends toward labor-intensive output imply that the recent rapid growth in manufacturing sectors has been associated with an even stronger increase in employment generation, presumably especially for semi-skilled workers who predominate in labor-intensive sectors. This constitutes a significant positive development in the Vietnamese economy, since unemployment remains a problem of utmost importance throughout Vietnam. As demand for labor increases over time and unemployment declines, pressure should develop to increase real wages, a key objective of economic development and a prime indicator of broad-based, rising prosperity. Furthermore, these trends re-enforce that Vietnam is growing in line with its comparative advantage, given its relatively large endowment of labor relative to capital and land.

C. THE STRUCTURE OF INVESTMENT

Paralleling the structural changes in employment are similar structural shifts in investment. The manufacturing sector's share in total investment has increased from 49 percent in 2000 to 55 percent in 2005. Within manufacturing, the share of labor-intensive to total manufacturing investment has also increased. Not surprisingly, however, given the legacy of state dominance in Vietnam's economy, more-capital-intensive sectors still absorb the bulk (about 75 percent) of investment in manufacturing. As Figure 33 indicates, manufactured investment grew strongly in 2001, with more-capital-intensive investment growing most rapidly. From 2002 to 2004, after the BTA came into effect, investment in labor-intensive manufacturing grew much more strongly than for more-capital-intensive sectors. As shown in Chapter 4, since some of the growth in labor-intensive investment in 2001 was associated with projects developed in preparation for the opening of the U.S. market (e.g. apparel, footwear, and wood and furniture), the dominance of capital-intensive investment in 2001 would have been even greater if the BTA was not on the verge of implementation.

Since 2001, therefore, investment in labor-intensive manufactured sectors, in which Vietnam has a strong comparative advantage, has consistently outpaced investment in more-capital-intensive sectors.

Figure 33: The Growth of Investment in Labor Intensive and Non-labor Intensive Sectors of Manufacturing: 2001-2004 (percentages)



Source: GSO

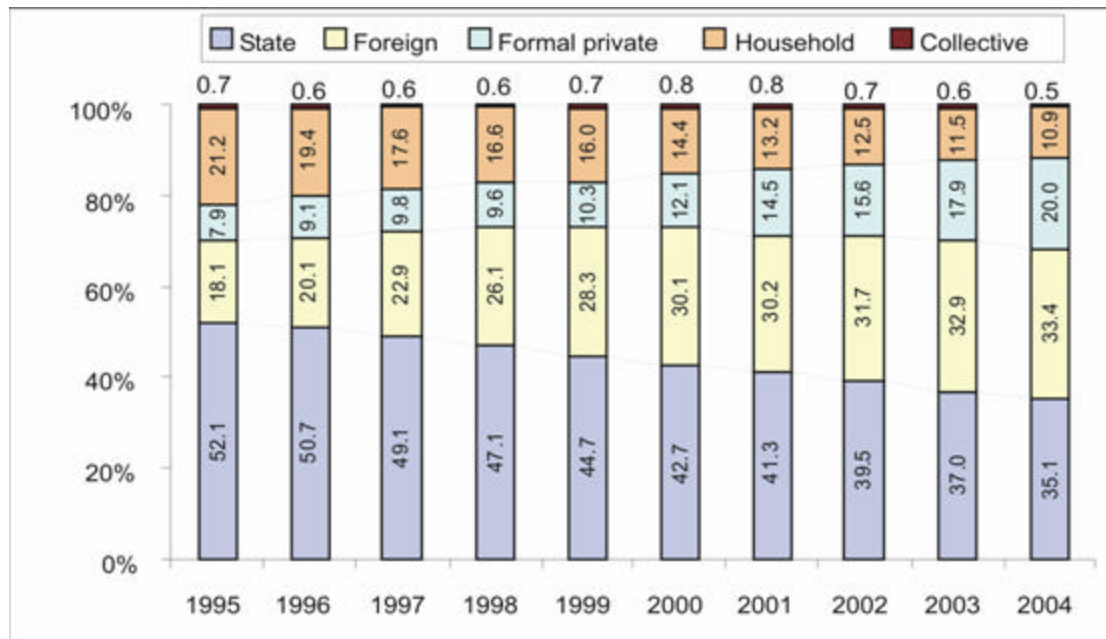
D.CHANGES IN OWNERSHIP STRUCTURE

The ownership structure of manufacturing over the period from 1995 to 2004 is shown in Figure 34. As one would expect, given the structural changes described above, the shares of foreign-invested and particularly domestic (formal) private firms in manufacturing output have expanded as the economy has become more export-oriented and concentrated in labor-intensive manufacturing activities. In labor-intensive sectors of manufacturing, both foreign-invested and domestic private firms play a much larger role than in capital-intensive sectors. In 2004, for example, the shares of foreign-invested and domestic private firms in the output of labor-intensive manufactures were 35 and 27 percent, compared to only 27 and 14 percent for their shares in output of capital-intensive manufactured sectors, respectively. While foreign and private shares have increased, manufactured output shares of state-owned and household sectors have declined substantially.

This shift in the center of gravity of Vietnam's economy away from SOEs to privately owned firms has occurred in part because of the opening of the U.S. market for Vietnamese exports as a result of the BTA and the larger force of comparative advantage as Vietnam's economy becomes more integrated into the international economy. This result has occurred because private (domestic and foreign) firms tend to be more competitive in export markets than SOEs. Critically, however, the many additional BTA/WTO-related and other reforms (such as the success of the Enterprise Law) introduced over the last five years have greatly expanded the economic space and reduced the transactional and regulatory costs associated with creating and operating private (including foreign)

enterprises, placing private firms on a much more level playing field with SOEs. This trend has been further stimulated by Government efforts to directly reduce the relative number of SOEs through rationalization and equitization. Since it is quite likely that foreign and private firms are more productive and efficient than state-owned and household firms, this trend represents a strong sign that Vietnam is establishing a solid foundation for long-term development.

Figure 34: The Ownership Structure of Manufacturing Output (percentages)



Source: GSO

ADDENDUM: EVALUATING THE IMPACT OF THE BTA ON FIRMS USING A SURVEY OF FIRMS FOR HO CHI MINH CITY

In 2004, the Ho Chi Minh City Institute of Economic Research (with support by Dr. Vu Quoc Huy), with support from STAR-Vietnam, undertook a survey of some 250 firms in and around Ho Chi Minh City in order to study the impact of the BTA on investment and employment at the firm level. We compare these firm-level results to our findings reported above using "macroeconomic" data. A corollary issue addressed in the survey was whether firms responded to the export opportunities opened up by the BTA by diverting exports from other markets to the United States or, instead, expanded production and employment to meet the new demand for their products in the United States.

Of the 250 firms surveyed, about 30 percent were removed from the sample due to anomalies in the data. One particular problem arose from the inclusion in the original sample of trading companies, which of course report large numbers of exports but little fixed investment or employment, since they do not actually produce the exported products. Eliminating trading companies and other anomalous responses yielded a final sample of 171 firms, including state-owned (16 percent), private (45 percent) and foreign-invested enterprises (39 percent), all in the manufacturing sector. Some 60 percent of these firms could be classified as small- and medium-sized enterprises (SMEs); the remaining 40 percent were large-scale enterprises. More than 80 percent of firms in the sample reported that they engaged in exporting, half of which exported to the U.S. market.

Export Orientation and Export Diversion

The finding in the macroeconomic data reported above of an increase in export orientation after the BTA came into effect was also observed in the firm survey results. As Table 22 indicates, the average number of firms that reported that they do not export declined by almost half in 2002 and 2003. Not surprisingly, the number of firms exporting to the U.S. market increased almost three-fold in the first two years of the BTA, while the number that exported to countries other than the United States remained roughly constant. Furthermore, the survey results suggest that contrary to the findings of other studies (Kokko, 2004), SMEs participated in the shift from the domestic market to exporting, in particular exporting to the U.S. markets. The fact that few firms abandoned non-U.S. markets while exploiting opportunities in the U.S. market after the BTA came into effect, suggests that export diversion was not significant and confirms similar findings reported in our 2003 report.

Table 22: Number of Firms by Export Status

	2000	2001	2002	2003
Export to non-US market	81	90	80	70
Export to both US and non-US market	23	26	58	67
<i>Of which, SME</i>	16	19	40	44
No export at all	67	55	33	34
Total	171	171	171	171

Source: Survey results.

As further evidence of the absence of export diversion, the study found that the growth of exports to the United States after the BTA was significantly positively correlated with the growth of exports to other markets. This finding was confirmed in interviews with firm managers who generally reported that while the share of other markets declined after the BTA came into effect, the absolute volume of exports to non-U.S. markets did not decline as exports to the United States expanded. It is worth noting that the finding that export diversion to the United States was not significant contradicts an influential study that predicted that the BTA would lead to significant export diversion (Fukase and Martin, 2000).

Production and Investment

The survey results indicate that the opportunities created by the BTA led to an expansion in exports, not only to the U.S. market, but overall—export diversion was not significant. It does not follow from this finding that production, investment and employment necessarily increased as a result of the BTA, however, since firms may have diverted sales from the domestic market to meet the increased demand in the U.S. market, or utilized excess capacity to increase production without investing in new production facilities.

The survey reveals, however, that the expansion of exports to the United States upon entry into force of the BTA did in fact lead to increased production and investment among the firms in the survey. These findings are summarized in Table 23, which reports the annual growth rates of sales, exports and assets for four groups of firms: (1) firms that export, but not to the United States, either before or after the BTA; (2) firms that exported to the United States and other markets both before and after the BTA; (3) firms that export to the United States only after the BTA; and (4) firms that do not export at all, but sell exclusively in the domestic market.

The results reported in Table 23 indicate a significant increase in exports, total sales, and investment in fixed and working capital in 2002, the first year of the BTA. The strongest response by far was for firms that entered the U.S. market for the first time in 2002. Firms that export, but not to the United States either before or after the BTA, reported more modest growth in production and investment in 2002. Regression analysis undertaken to determine whether the association between export expansion, and production and investment across the different categories of firms was statistically significant, generally confirming our conclusions.

Table 23: Annual Growth Rates in Sales, Exports and Assets, by Firm Export Status
(percentages)

	Total Sales	Total Exports	Equipment	Assets	Working Capital
Full sample of firms					
2001	2.3	19.9	15.3	10.8	13.0
2002	31.3	35.7	14.6	18.0	24.9
Firms that export to the non-US market, but never to the US					
2001	8.4	9.5	12.0	10.1	29.0
2002	14.4	2.9	24.5	16.6	16.1
Firms that export to both markets, before and after the BTA					
2001	24.5	30.6	10.4	12.8	16.1
2002	25.8	22.0	22.4	25.7	21.8
Firms that export to the United States only after the BTA					
2001	7.2	-7.3	11.0	8.5	24.9
2002	57.3	144.0	48.7	23.9	58.7
Firms that do not export, but sell only domestically					
2001	-5.7		16.4	10.7	6.9
2002	30.4		-0.3	13.8	20.1

Source: Survey results

Employment

Similar analysis for employment and wages is reported in Table 24. Taken at face value, the results suggest that the employment effect of the BTA was modest at best. Since this evidence is not consistent with the macroeconomic data reported above, we suggest caution in interpreting these results. There is some sensitivity on the part of firms toward reporting employment figures that could lead to erroneous data. Also, as with the results in Table 22, the survey covered only one year, the first year of the BTA, so its impact on investment and employment may not be fully revealed in the survey data.

Table 24: Annual Growth Rates in Employment and Wages, by Firm Export Status
(percentages)

	Skilled worker	Unskilled worker	Wage
Full sample of firms			
2001	16.6	11.7	-0.2
2002	14.1	6.8	12.9
Firms that export to the non-US market, but never to the US			
2001	21.4	3.5	4.9
2002	4.4	-5.1	9.8
Firms that export to both markets, before and after the BTA			
2001	5.5	23.9	2.4
2002	6.8	8.7	8.5
Firms that export to the United States only after the BTA			
2001	9.3	5.2	2.0
2002	19.9	2.6	12.5
Firms that do not export, but sell only domestically			
2001	13.8	0.0	6.8
2002	37.7	15.1	5.1

Source: Survey results.

In summary, the result of this survey, first of all, reflects the difficulty of getting a representative sample of detailed operational data from firms. Our initial attempt to develop a survey of firms in a number of provinces in the north and south of Vietnam was not successful. Clearly, as well, the limited sample period for only 2001 and 2002 surely misses many of the more evolving impacts of the BTA on firm behavior in Vietnam. Nevertheless, the results garnered from this survey in large part reinforce the findings from the macroeconomic data—that is, that many firms responded aggressively to export to the United States market once essentially prohibitive tariff levels were reduced to MFN levels by the BTA. Those firms that started to export to the United States in 2002 expanded sales and investment more rapidly than firms exporting only to non-U.S. destinations, or selling only to the domestic market. The BTA clearly injected a growth dynamic to a number of firms in the HCMC area. Although this result may seem obvious now, it is important to remember that many in Vietnam felt that the BTA was one-sided in its benefits for the United States, and they doubted the ability of Vietnamese firms to compete successfully in the highly competitive and legalistic U.S. market. Clearly, however, further study is required to understand with more rigor how Vietnamese responded at the firm level to the multi-faceted impacts of the BTA.

CHAPTER 7

THE BTA AND THE BANKING SECTOR IN VIETNAM

A principal obligation for Vietnam under the BTA is to reform its trade and investment regimes by removing unjustifiable restrictions on foreign investment and ultimately giving foreign investors national treatment in Vietnam. As a developing country, Vietnam has been given a period of years to phase-in implementation of most of its investment and trade in services' commitments. Similar requirements in the WTO accession protocol, again often with phase-in periods, build upon and expand those commitments in the BTA. Once fully implemented, the likely effect will be to increase competition from U.S. and other foreign investors in key sectors that have been highly protected in the past. One such sector in which foreign firms are judged to be more competitive than domestic ones is banking.

There is understandable concern in Vietnam that full implementation of the BTA/WTO obligations to open the domestic banking sector to competition from U.S. and other foreign banks will have deleterious effects on domestic banks, especially the state-owned commercial banks (SCOBs). This concern stems from both the strong competitive position of U.S. banks in international financial markets and the weakness of the domestic banking sector, which is plagued with a large stock of non-performing loans and a high level of inefficiency nurtured during decades of isolation from market discipline and foreign competition.

Vietnam is not unique among developing countries in terms of the weakness of its financial sector in general and banking system in particular. A policy of "financial repression," characterized by interest rate controls, policy-based lending, high reserve requirements, and other measures that help finance government spending at the cost of undermining the efficiency of the banking system, was (and still is to a large extent) commonplace in developing countries.

In most developing countries, financial sector liberalization has taken a backseat to liberalization of trade and industrial policy, often occurring only after decades of industrialization and income growth. This has been the case for Vietnam as well. However, with the rapid integration of international financial markets and the expansion of the WTO mandate to encompass trade in services,

and in particular banking, developing countries have been induced to accelerate the pace of financial sector liberalization and open their banking sectors to foreign competition. As a consequence, over the past decade, a number of developing countries have faced the same challenges that Vietnam faces today under its BTA and WTO obligations.

The consequences of BTA implementation on the banking sector in Vietnam will not be fully known for several more years. However, the experiences of other developing countries that have undertaken similar measures over the past decade provide a useful base of information about what to expect from the implementation of these obligations. Before we proceed to examine the literature on the impact of foreign bank entry in developing countries, we provide a brief assessment of the banking sector in Vietnam, the role of foreign banks currently, and the obligations that Vietnam has under the BTA to increase the access of U.S. banks in the domestic banking market.

A. BRIEF OVERVIEW OF THE VIETNAMESE BANKING SECTOR

As a sign of the immature development of Vietnam's financial sector, publicly-available data on financial activities are limited, which will make this overview of the current banking sector brief. What is known is that four (of six) state-owned commercial banks (SOCBs) dominate, accounting for 81 percent of domestic currency loans and 53 percent of dollar loans at the end of 2005 (see Table 25). In addition to the four SOCBs, the banking system consists of 39 relatively small, privately-held joint-stock banks, 6 joint-venture banks, and 31 foreign branch banks.¹ As many as 54 joint-stock banks were established in the early 1990s, but closures and mergers have reduced that number. The six joint-venture banks, all quite small, are each owned 50 percent by a SOCB and a foreign bank. There are 31 foreign branch banks, eight of which were established in the past five years. Together, foreign branches account for only 4 percent of domestic currency loans and 20 percent of dollar loans. Although they have grown rapidly in recent years, as restrictions on their activities have been loosened, they remain a relatively small segment of the overall banking system.

¹ In addition, there are about 46 representative offices of foreign banks, but they are prohibited from offering banking services in the domestic market. Also note that state-owned firms are important owners of many joint-stock banks.

Table 25: The Banking Sector as of December 2005

	SOCBs	Joint-Stock Banks	Joint-Venture Banks	Foreign Branch Banks
Number of banks	6	39	6	31
Domestic currency loans (VND billions)	240,654	43,491	2,357	11,040
Percentage share (%)	81	15	1	4
Dollar loans (USD millions)	4,866	986	1,543	1,822
Percentage share (%)	53	11	17	20

Source: IMF unpublished data. World Bank, *Banking Sector Review: Vietnam*, 2003

Formal financial intermediation has grown rapidly over the last five years, as the public's confidence in banks, insurance companies and other financial institutions improve. Credit to the economy has grown between 20 and 40 percent annually over these years (see IMF 2006).

B. KEY BTA OBLIGATIONS AFFECTING U.S. BANKS

The timeline of Vietnam's commitments under the BTA to open up its banking sector to U.S. banks is shown in Table 26.

Table 26: Timeline of BTA Commitments to Open the Banking Sector to U.S. Banks

Effective on December 10, 2001	Number of U.S. branch banks no longer subject to a country quota National treatment for U.S. shares in equitized commercial banks
Phased in to 2010	Joint ventures allowed with U.S. equity between 30 to 49%
December 10, 2002–December 10, 2011	Phase out limitations of acceptance of VND deposits from Vietnamese legal persons; full National Treatment
As from December 10, 2004	U.S. branch banks are allowed to take initial mortgage interest in land use rights held by foreign-invested enterprises U.S. branch banks are allowed to acquire and use mortgages of land use rights for liquidation in the case of default U.S. branch banks have access to rediscounting, swap and forward facilities of the State Bank
December 10, 2010	100% U.S.-owned subsidiary banks allowed

With Vietnam's accession to WTO, a number of commitments listed above will be accelerated. For example, all foreign banks will be able to establish 100 percent-foreign-owned subsidiaries as of April 1, 2007. The WTO clarifies that overall foreign bank equity participation in Vietnamese joint-stock banks are capped at 30 percent.

C. BANKING REFORMS SINCE THE BTA

The government has made a number of changes over the last several years to prepare domestic banks to meet the challenge of greater competition from foreign banks. In 2001, the government began a comprehensive program of banking sector reform, which included restructuring the SOCBs, consolidating the small undercapitalized joint-stock banks, and improving the regulatory, supervisory, and institutional frameworks for the banking sector. One of the pillars of the restructuring of the SOCBs is equitization. All SOCBs are to be fully equitized by 2010, when foreign banks gain national treatment. It is expected that one major SOCB (Vietcombank) will be equitized by the end of 2007, with its shares sold in part through auctions at the HCMC Stock Exchange. By 2010, the government's share in equitized SOCBs is to be capped at 51 percent. Foreign banks individually have been limited to a 10 percent share in equitized SOCBs, with a combined share of foreign bank investment in an equitized SOCBs not to exceed 30 percent. In late 2006, the 10 percent limit was increased to 15 percent.

In addition to strengthening Vietnamese banks, the government has also taken measures to improve bank regulation and supervision. In 2005, new regulations on debt classification were issued that follow international standards of debt classification. New regulations on capital adequacy and other bank safety ratios have been issued, as have regulations on money laundering and information disclosure, all of which aim to bring the system of regulation and supervision in Vietnam closer to international standards. These are all meant eventually to apply to all banks operating in Vietnam, whether private, foreign or state-owned.

The government's program of bank restructuring and regulatory reform has already shown positive results. Since 2004, bank profits have grown significantly and listed banks are increasing dividends to shareholders. It is reported that Vietnam's joint-stock banks are using retained earnings and issuing new stock on the Stock Exchange to bolster bank equity and improve capital adequacy ratios in line with the governments announced targets.

Vietnam's banks, in spite of recent progress, remain relatively weak. Although many joint-stock banks appear to meet the established 8 percent capital adequacy ratio, the dominant SOCB's do not. The State Bank reported that the

stock of non-performing loans (NPLs) in the banking system in 2005 was 4.4 percent, but the World Bank, IMF and independent international credit rating agencies estimate it to be between 15 and 30 percent, which would suggest that the system as a whole may be insolvent. In addition, the services offered by Vietnamese banks are undiversified and generally of a low quality. In a recent UNDP survey, 50 percent of respondents reported that they would shift their deposits to foreign banks once restrictions on foreign banks are eliminated, and 45 percent responded that they would prefer to borrow from a foreign bank than from a domestic bank.

D. THE IMPACT OF FOREIGN BANK ENTRY: A SURVEY OF INTERNATIONAL EXPERIENCE

Allowing foreign banks to operate in Vietnam on the same terms as domestic banks, as Vietnam is obliged to do fully by 2010, will undoubtedly intensify competition in the banking system. But, will increased competition have the salutary effect of forcing domestic banks to become more efficient, allowing them to survive and perhaps even flourish in the new environment? Or, will foreign bank entry in Vietnam lead to domestic bank failures and create instability in the local financial system? There is also a question of whether foreign bank entry is likely to reduce access to credit of small and medium sized enterprises, since foreign banks operating in developing countries tend to favor larger borrowers. Tentative answers to these questions can be found in the growing literature on the experiences of developing countries that have preceded Vietnam in liberalizing their financial systems and allowing foreign banks to operate freely in their domestic banking sectors.

Competition and Efficiency

Does foreign bank entry intensify competition in the domestic banking market and thereby force domestic banks to become more efficient? Most of the literature on this issue has focused mainly on banking markets in developed countries, and has found that in developed countries foreign banks tend to be less efficient and less profitable than their local competitors. Within the past five years, however, new bank-level data have become available that allow researchers to address this question for developing countries. Interestingly, they find the opposite relationship between foreign and domestic banks in developing countries—namely, that foreign banks tend to be more efficient and profitable than their domestic competitors (Clarke, et. al, 2001). Indeed, it has been suggested that the inefficiency of domestic banks in the host countries is one of the attractions for foreign banks entering a new market (Focarelli and Pozzolo, 2000).

Using bank-level data for 80 countries over the period 1988-95, Claessens, Demirgüç-Kunt and Huizinga (1998) found econometric evidence that “foreign bank entry can render national banking markets more competitive, and thereby can force domestic banks to start operating more efficiently” (p.18). In particular, they find that the larger the share of foreign banks in the domestic banking market, the lower the profitability and the lower the operating costs of domestic banks. Thus, while the removal of restrictions on the entry and activities of foreign banks appears to lower the profitability of domestic banks, it does seem to improve the functioning of the banking system as a whole, with clear positive implications for bank customers and national welfare.

A more recent study (Claessens and Laeven, 2003) using bank-level data for 50 countries over the period from 1994 to 2001 to estimate a structural model of competitiveness, finds similar results—“greater foreign bank presence and fewer activity restrictions in the banking sector can make for a more competitive banking system” (p.23). However, a more novel finding of this study was that the degree of concentration in the banking sector did not, contrary to what is often presumed to be the case, influence the competitiveness of the system. They justify this result by explaining that industrial organization theory suggests that contestability, rather than industry structure, is most important for competition. Thus, allowing for foreign bank entry is all the more important and beneficial for banking systems that are highly concentrated, especially when the highly concentrated banks are state-owned, as they are in Vietnam.

Asian countries, while having experienced rapid financial deepening in the recent years, continue to limit, in varying degrees, the penetration of domestic banking markets by foreign firms. However, the econometric findings based on international cross-country data appear to apply in the Asia region as well. Net interest margins are lower, overhead costs are lower, and profits are higher, in Asian banking systems that are more open to foreign bank participation. For Asian developing countries specifically, a recent study concludes that “the limited openness to date has been costly in terms of slower institutional development, greater fragility and higher costs of financial services” (Claessens and Glaessner, 1998, p.31).

Foreign Bank Entry and Financial Stability

It has been observed that financial crises in developing countries tend to be preceded by financial liberalization, one component of which is typically liberalizing restrictions on foreign bank entry (Kaminsky and Reinhart, 1999). It does not follow, however, that foreign bank entry contributes to the likelihood of a financial crisis in liberalizing countries. Indeed, evidence suggests that foreign

banks contributed to stability during the financial crises in Latin American and Asia in the 1990s.

A study of bank lending during the financial crises in Mexico and Argentina in the 1990s indicates that foreign banks were a stabilizing force (Goldberg, Dages and Kinney, 2000). During the financial crises in these countries, and immediately thereafter, foreign banks exhibited stronger loan growth and less loan volatility than domestic banks, thereby contributing, according to the authors, to greater stability in the overall financial system (Goldberg, et.al., p. 23). The evidence from Mexico and Argentina suggests, according to this study, that “diversity in ownership appears to contribute to greater stability in times of crisis and domestic financial system weakness.”

A separate study of bank lending in the East Asian countries that experienced banking crises in the late 1990s (Indonesia, Korea, Malaysia, the Philippines and Thailand) finds that foreign banks took little risk relative to other banks in the region in the years leading up to the crisis (Laeven, undated). As a result, in the aftermath of the crisis, it was mainly domestic banks, not foreign banks, that had to be restructured. Cross-country evidence also indicates that foreign bank presence reduces the likelihood, other things equal, of a banking crisis (Demirgüç-Kunt, Levine and Min, 1998), perhaps because systems that restrict foreign bank entry tend to have lower loan portfolio quality and greater fragility in the financial sector (Barth, et.al., 2000).

Because foreign banks have more diversified portfolios and greater access to funds around the world through their parent companies, they are less exposed to risk and less affected by negative shocks in a host country. For this reason, Mishkin (2001, p. 26) suggests that “encouraging entry of foreign banks is thus likely to lead to a banking and financial system that is substantially less fragile and far less prone to crisis.” Another reason for encouraging foreign bank entry, he suggests, is that foreign bank presence encourages the adoption of better risk management techniques by local banks and can induce regulators to demand better risk management techniques in the system as a whole.

Foreign Bank Entry and Access to Credit

In general, foreign banks operating in developing countries tend to lend mainly to larger companies, while domestic banks are more active in areas of consumer credit and lending to smaller companies in the commercial and industrial sectors (Clarke, et.al. 2001, p.21). The orientation of foreign banks toward serving larger companies has raised a concern that increased foreign-bank presence in developing countries may worsen the access to credit of small- and medium -sized

companies (SMEs).¹ This outcome would be all the more likely if competitive pressure from foreign bank entry were to crowd out smaller domestic banks that are the principal lenders to SMEs in developing countries. This is, of course, an important issue since the expansion of SMEs is critical for labor abundant countries, like Vietnam, that are pursuing an export-oriented industrial strategy.

It is, however, possible that despite the orientation of foreign banks toward larger borrowers, that foreign bank entry could improve the access to credit of SMEs in developing countries. If foreign banks displace domestic banks lending to larger borrowers, the domestic banks may be forced to rely more on lending to SMEs. Moreover, if foreign bank entry increases overall competition and improves the borrowing terms for all customers, SMEs would likely benefit along with larger enterprises. The relationship between foreign bank entry and SME access to credit is, therefore, an empirical issue.

Empirical evidence on this issue for developing countries has only just begun to emerge. One of the first studies on this issue, by Clarke, Cull and Martinez Peria (2001), used a survey of over 4000 enterprises in 38 developing and transition economies to study the perceptions of borrowers regarding the impact of foreign banks on their access to credit and on the terms of borrowing. Their study confirms that foreign bank penetration of domestic banking markets in developing countries is perceived by borrowers to have improved banking services overall, giving borrowers greater access to credit and better terms (e.g., lower interest rates). Furthermore, they find that “the benefits of high levels of foreign bank penetration do not appear to accrue only to large enterprises” (p. 21). While it appears that larger enterprises benefit from foreign bank penetration more than smaller ones, they conclude that “there is strong evidence that even small enterprises benefit in some ways and there is no evidence that they are harmed by foreign bank entry.”

A related study (Beck, Demirgüç-Kunt and Maksimovic, 2003) using survey data for about 6000 firms in 74 countries on firms’ perceptions of financing obstacles, reaches a similar conclusion. Their results indicate that, in general, financing obstacles are greater in countries with more concentrated banking markets, and that the effect of market concentration on access to credit is more severe for smaller firms. The negative effects on credit access to SMEs are less severe, they find, in countries with well developed financial institutions, higher levels of financial development, and a larger share of foreign-owned banks. To alleviate the negative impact of bank concentration, they recommend policy

1. Berger, Klapper and Udell (2000) find that small companies in Argentina are less likely to get credit from large domestic banks or from foreign banks than large companies. A similar pattern is found in Chile, Columbia and Peru (Clarke, Cull, Martinez Peria, and Sanchez (2001).

measures that reduce restrictions on banking activities overall and on the entry and activities of foreign banks in particular.

The Case of China

The case of China is especially pertinent for Vietnam. Like Vietnam, China is a classic case of a financially repressed economy—state-owned banks dominate the banking sector and the banking sector dominates the financial system. State-owned banks have until quite recently exhibited the features common to monopoly state ownership—a NPL ratio sufficient to render the banks insolvent, poor governance, low efficiency, and low profitability. In the absence of interest rate controls, the state-owned banks would likely have operated in the red, raising the prospects of a banking crisis. Also like Vietnam, China has an obligation to remove all restrictions on foreign bank entry, in China's case in January 2007.

We will not know the outcome of free entry of foreign banks for several years, but there is clear evidence that the stock market is optimistic about the prospects of China's state-owned banks. The share prices of Chinese banks rose 47 percent in 2006. Earnings per share of Chinese banks are expected to rise 32 percent in 2007 (UBS 2006). The year 2005 witnessed a highly successful IPO for the state-owned China Construction Bank. In 2006, the state-owned Bank of China's IPO raised US\$9.7 billion, while a third state-owned bank—Industrial and Commercial Bank of China—had the largest IPO in history at US\$21.9 billion.

The current scenario for China's state-owned banks could not have been imagined six years ago, when China entered the WTO and agreed to give foreign banks national treatment in 2007. Through capital injections and improved regulation and supervision, the government has done much to improve the balance sheets of the state-owned banks. During the past five years, the government has also begun to ease restrictions on foreign bank operations in China. As a result, their number has increased to 211, although their share of bank assets is no more than about 2 percent. Instead of expanding branch operations in China, foreign banks have focused on making strategic investments in domestic state-owned and private joint-stock banks. Thus, in the past five years, in spite of a 20 percent equity share limit, 25 foreign banks have taken equity position in domestic banks over the past five years.

We may conclude, therefore, that the experience of China regarding foreign bank entry is consistent with that of other developing countries. The threat, if not the presence, of foreign banks has led to significant improvements in the performance of domestic banks in China. Consequently, when national treatment

is accorded in 2007, there is little concern that China's domestic banks will be put at jeopardy. Instead, the outlook is for foreign banks to enter the domestic market, not by establishing competing branch networks, but instead by forming strategic partnerships with domestic banks, which should strengthen local banks by providing technical know-how, improve corporate governance and improve capital adequacy ratios.¹

1. This strategy is prevalent in Vietnam as well, with major foreign banks buying shares of the strongest joint-stock banks. For example, the following foreign banks have bought equity stakes and are strategic partners with Vietnamese joint-stock banks: ANZ Bank with Sacombank (Saigon Commercial Bank); Duestche Bank with Habubank (Hanoi Housing Bank); Standard and Charter Bank with ACB (Asian Commercial Bank); HSBC with Techcombank (Technological and Commercial Bank; and Paribaswith Oriental Bank.

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**APPENDIX TABLE 1: VIETNAM'S TOTAL EXPORTS TO THE U.S. BY
COMMODITY CATEGORY (US\$ millions)**

	1999	2000	2001	2002	2003	2004	2005	2006
Total	609	822	1,053	2,395	4,555	5,276	6,630	8,566
Primary Products	400	593	820	994	1,276	1,310	1,686	2,209
Fish & seafood	140	301	478	616	732	568	630	653
Vegetables & fruit	29	53	50	76	106	184	179	186
Coffee	100	113	76	53	76	114	157	204
Crude rubber	3	5	3	11	13	17	23	31
Petroleum	101	88	183	181	278	349	605	1,036
Other primary prod.	27	33	30	57	71	78	92	99
Manufactured Goods	210	229	232	1,401	3,279	3,966	4,943	6,357
Non-metal Mineral prod.	5	7	9	20	28	32	40	51
Metal manufactures	3	3	4	8	16	31	64	120
Electrical appliances	1	1	1	5	4	3	6	6
Furniture	4	9	13	80	188	386	692	895
Travel goods	1	2	1	50	86	110	114	116
Apparel	36	47	48	900	2,380	2,571	2,738	3,239
Footwear	146	125	132	225	327	475	721	960
Misc. manufactures	2	15	3	28	49	92	158	247
Other manufactures	12	20	21	85	201	266	410	723

Source: U.S. International Trade Commission, Trade Database (online: www.usitc.gov)

**APPENDIX TABLE 2: VIETNAMESE EXPORT, IMPORT AND TRADE BALANCE
TRENDS (US\$ millions)**

	2000	2001	2002	2003	2004	2005	2006
EXPORTS							
Annual Growth of Exports to U.S.		45%	127%	63%	27%	19%	32%
Exports to Rest of the World (ROW)	13,750	13,964	14,253	16,237	21,493	26,511	31,997
Annual Growth of Exports to ROW		2%	2%	14%	32%	23%	21%
Total VN Exports	14,483	15,029	16,674	20,176	26,485	32,442	39,826
Annual Growth of VN Exports		4%	11%	21%	31%	22%	23%
Share of Total Exports to U.S.	5.1%	7.1%	14.5%	19.5%	18.8%	18.3%	19.7%
IMPORTS							
Imports from U.S.	363	411	458	1,143	1,134	864	982
Annual Growth of Imports from U.S.		13%	12%	149%	-1%	-24%	13.6%
Vietnam Imports from ROW	15,273	15,807	19,296	24,113	30,835	36,114	43,909
Annual Growth of Imports from ROW		3%	22%	25%	28%	17%	22%
Total Imports	15,637	16,218	19,755	25,256	31,969	36,978	44,891
Annual Growth of Total Imports		4%	22%	28%	27%	16%	21%
Share of Total Imports from U.S.	2.3%	2.5%	2.3%	4.5%	3.5%	2.3%	2.2%
TRADE BALANCE							
VN Trade Balance	-1,154	-1,189	-3,080	-5,080	-5,484	-4,536	-5,065
Trade Surplus with the U.S.	369	655	1,963	2,795	3,858	5,066	6,847
Trade Deficit with ROW	-1,523	-1,843	-5,043	-7,875	-9,342	-9,602	-11,912

Source: GSO and Ministry of Trade

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